

# ESSENTIALS OF ECONOMICS



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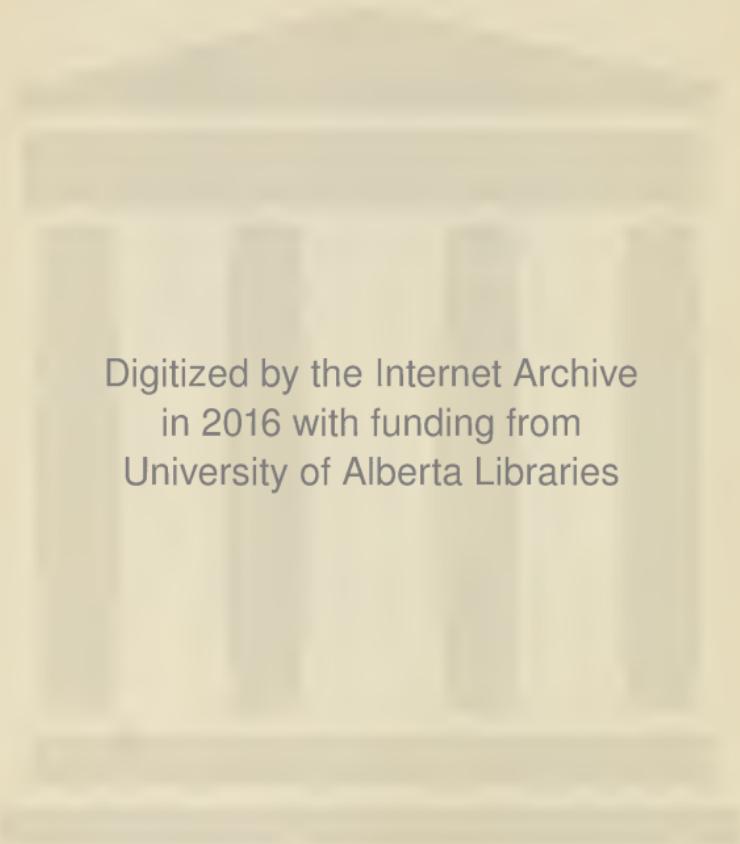
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# ESSENTIALS OF ECONOMICS

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# Essentials of Economics

BY

CHARLES QUENNEVILLE, B.A., PH.L.  
WINDSOR VOCATIONAL HIGH SCHOOL



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## FOREWORD

The first requirement for the successful teaching of any subject to Secondary School students is a textbook based on class-room experience. Due to the force of circumstances no such text, written from the Canadian viewpoint, has been available for the teaching of Elementary Economics. *Essentials of Economics* is the gradual outgrowth of mimeographed material prepared by the author to supplement existing texts. Many topics not treated in other texts on account of their apparent difficulty have been included. The author is convinced that no purpose is served in unduly diluting the contents of a course of study. Canadian youth when put to the acid test of honest work and hard thinking show the quality of their pioneer ancestry. To give them the impression that they are learning realities when they are dealing only with superficialities is to lead them into a fool's paradise. The difficulties presented to them in this book are not greater than those met with in the study of Elementary Geometry.

Three main criteria have been used in selecting contents: teachability, social worth and thinking outcomes. In the light of these criteria much has been added and much has been rejected as unsuitable.

The main purpose kept in mind at all times has been to give the inexperienced student every assistance in acquiring a clear-cut picture of our economic system along with a firm conviction of Canada's excellence in many fields of world economic activity.

The earnest student who carefully thinks out the answers to the questions appended to each chapter will soon acquire not only a precise delineation of the productive and monetary mechanics of our economy, but he will at the same time become proficient in the interpretation of statistical information. He will also develop a sense of real appreciation of his country's striking greatness and tremendous potentialities.

## FOREWORD

No effort has been spared in obtaining the latest statistics available. For his success in achieving this aim the author is greatly indebted to the officials of the Dominion Bureau of Statistics. Several Departments of the Dominion and Provincial governments, the Royal Bank, the Canadian Bank of Commerce, the Provincial Bank and A. E. Ames and Company have also been of assistance.

The graphs and diagrams, unless otherwise indicated, have been drawn by C. N. Cole, of the Draughting Staff of the Windsor Vocational High School.

C. Q.

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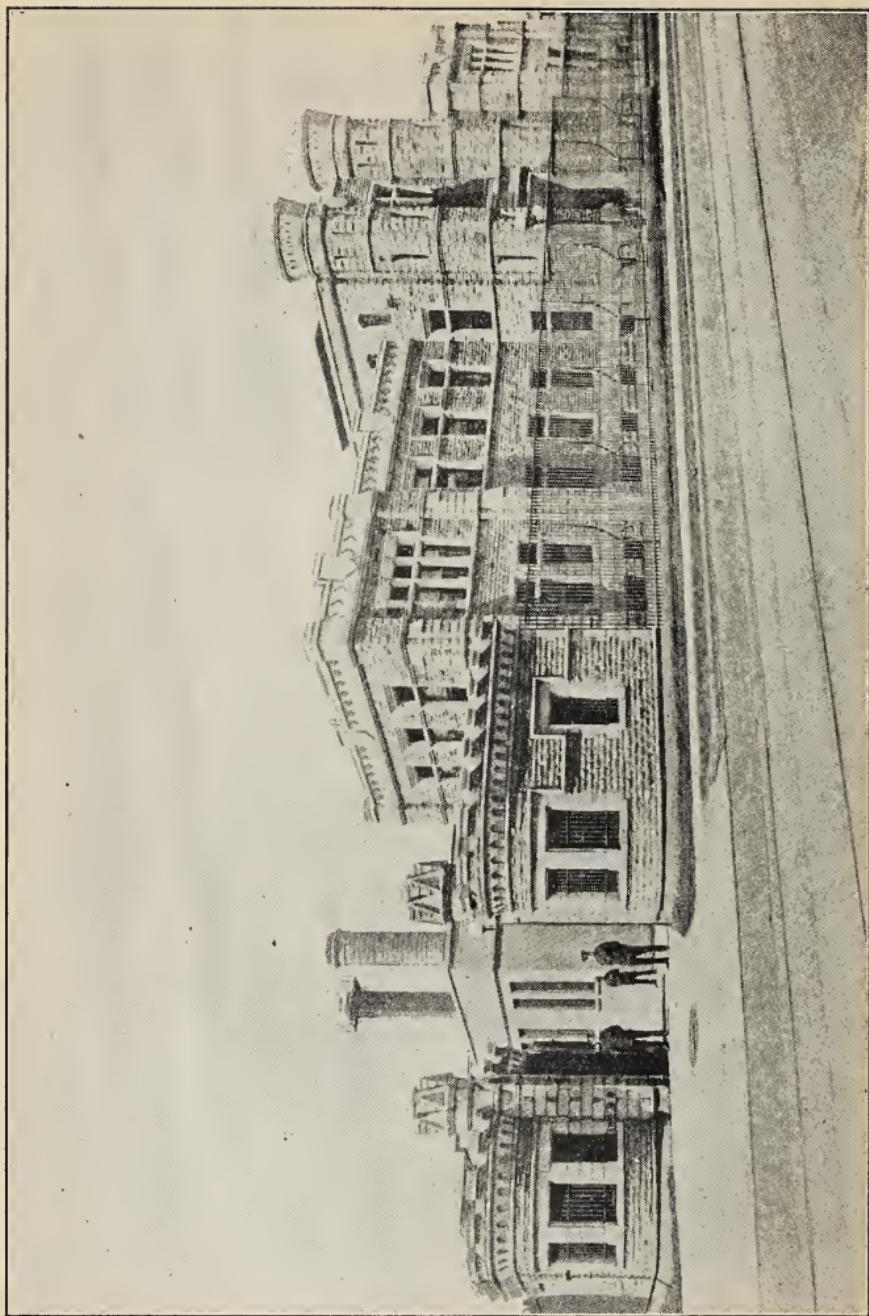
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THE ROYAL CANADIAN MINT

# Essentials of Economics

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## CHAPTER I

### THE MEANING AND SCOPE OF ECONOMICS

**Definition.** Economics is the scientific study of man's wealth-producing, wealth-exchanging, wealth-distributing and wealth-consuming activities. In satisfying his wants, man consumes wealth. Since the production of wealth is best accomplished through co-operation, man produces it with the help of his fellow men, instead of working individually. Co-operation has brought about the development of a system of production in which the work is divided among the members of the group called human society. Evidently, if the work of producing wealth for the satisfaction of human wants is divided among the producers, the total wealth produced must be divided among the consumers.

The great army of producers and the still greater army of consumers, who strive to acquire as large a share as possible of the total wealth produced, make the economic system a huge and complex mechanism which can be understood only with great care and patient study.

**The Principal Divisions of Economics.** Certain natural divisions exist in the economic system.

1. Man has wants which can be satisfied only through consumption. The study of consumption, therefore, will be the first step in our inquiry.

2. Consumption can take place only after the production of wealth. Production will be the subject matter of the second phase of our work.

3. Production is carried on by co-operative effort; that is, the work is divided among the producers who specialize, each in his own line. It follows that the wealth produced must be exchanged. Exchange will be the third part of our subject.

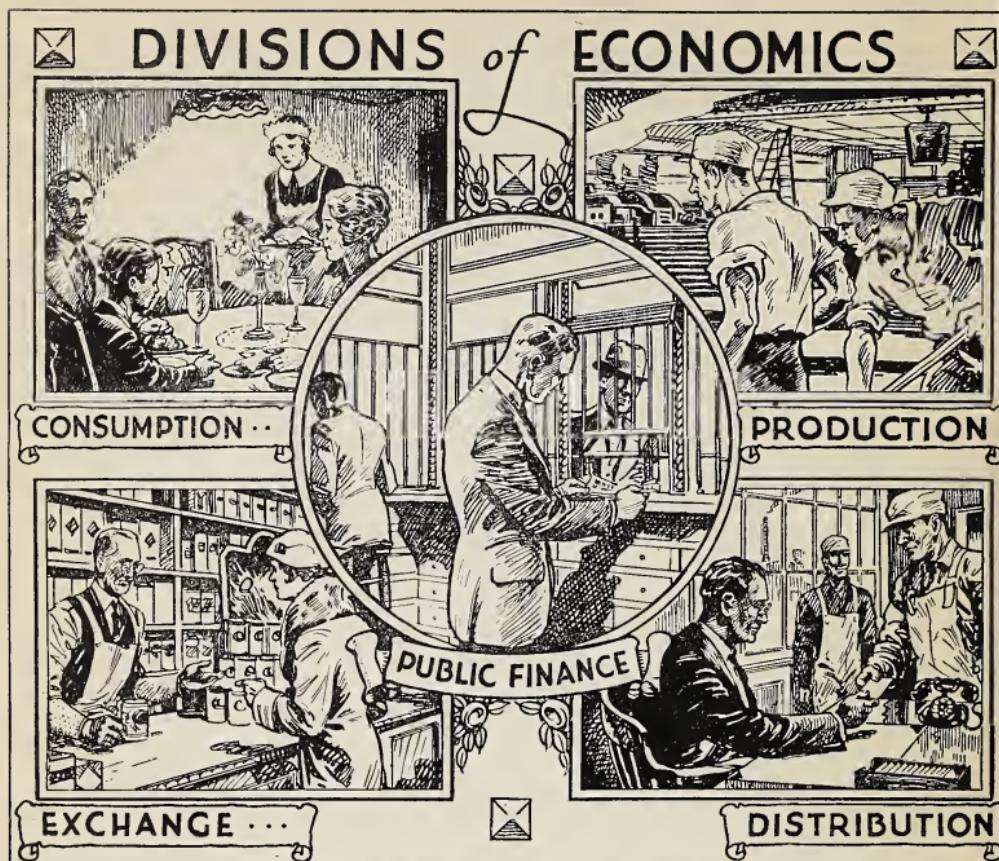


FIG. 1.

4. Since the wealth produced must be divided, it is of prime importance to know under what conditions each share will be allotted. This is the phase of economics called distribution.

5. Consumption, production, distribution and many other factors outside the field of economics give rise to problems which can be settled only by all the people or by their representatives. The elected representatives, the appointees and the civil servants who look after this general business of the people must be given a share of the wealth produced. This is taken care of by public budgets. Public finance will be the final step in our survey of the economic system.

**The Social Sciences.** A group of people working towards a common end is a human society. Man, working with his fellow men for the common purpose of satisfying human wants, shares in group activities toward procuring this satisfaction. Any science which deals with the activities of the individual as a member of a group is a social science. The social sciences may be classified into three groups:

A. The purely social sciences.

1. Politics.
2. Economics.
3. History.
4. Jurisprudence.
5. Anthropology.
6. Penology.
7. Sociology.

B. The semi-social sciences.

1. Ethics.
2. Education.
3. Social Philosophy.
4. Social Psychology.
5. Social Hygiene.

C. The sciences with social implications.

1. Biology.
2. Geography.
3. Linguistics.

**Economic Laws.** Certain effects occur over and over again, in a similar fashion, when similar causes exist. Bad money drives good money out of circulation. The cause is the presence of bad money; the effect is the flight of good money. When the same effects occur repeatedly as consequences of the same causes there is said to be a law. In this case it is known as Gresham's Law. An economic law is not a statute passed by a legislative body.

An economic law is the tendency of certain economic events to repeat themselves under similar conditions.

**Relationship.** Scientific study demands the investigation of relationships. What constitutes a relationship may best be understood from a study of the following cases.

1. Possible war needs are responsible for the greater wheat acreage in Europe. Possible war needs and wheat acreage are related to each other as cause and effect.

2. The cost of a steamship ticket changes as the number of miles travelled increases. The cost and the distance change together.

3. Pulp production increases with newsprint exports. Production and exports change together in the same direction, or vary directly. They are so related that an increase in one is accompanied by an increase in the other.

4. As the number of houses increases, rents decrease. The number of houses and rents change at the same time, but in opposite directions, or vary inversely. They are so related that an increase in one is accompanied by a decrease in the other.

There are many economic facts so related that a change in one is accompanied by a change in another. In economics we shall study not only facts, but also their relationships; that is, how a change in one fact is accompanied by a change in another fact, and how changes in one set of facts are accompanied by changes in other sets of facts.

**Advantages of Studying Economics.<sup>1</sup>** Any student who applies care and diligence to the study of economics may reasonably expect to derive the following advantages from his work.

1. The ability to distinguish sound business and economic principles from propaganda, to think intelligently and to decide wisely on questions of public business.

2. The power to visualize the economic interdependence of peoples in the business world.

3. The capacity to benefit from the constant use of such economic indexes and financial comments as are commonly found in the financial sections of daily newspapers.

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<sup>1</sup>Adapted from New Jersey and Minnesota Courses of Study.

4. The habit of cautious, rational and accurate economic thinking.
5. A broader culture which will bring greater benefit and enjoyment from social discourse, travel, reading, talking pictures, radio and other like recreations and pleasures.
6. An appreciation of the importance of international good will.

**Human Welfare.** Evidently, economics is not the study of how to become rich quickly. It has a nobler aim than mere individual prosperity. It assumes that all men are not born equal, that there are geniuses and imbeciles of a wide variety of degrees of intelligence. This leads to the conclusion that if life is to be nothing but a mere scramble to make the best of things, then life will be an intolerable burden for the maimed, the halt and the blind. Those who have not been endowed with sufficient intelligence will fail to have their necessary wants satisfied. The aim of economics is to obtain a maximum of enjoyment for all who strive, rather than the building up of the strong at the expense of the weak.

Economics also seeks to set up conditions which will improve the moral fabric of the people. Millions of automobiles, miles of concrete, and tons of pig iron may mean prosperity for a great section of the population, but are not a guarantee of character and integrity.

#### EXERCISES AND PROBLEMS

1. Define economics.
2. Is economics a study of men or of things or of both? Explain.
3. What is scientific study?
4. What is the meaning of distribution as a division of economics?
5. Name three activities in school life which demand group action.
6. What is a society?
7. Show why economics is primarily interested in man's relation to others.
8. Define science; social science; exact science; pure science; applied science.
9. Why is economics a social science?
10. Consult an encyclopaedia and obtain the definitions of five other social sciences.
11. What difference exists between an economic law and a statute passed by a legislative body?

12. Define economic law.
13. State five examples of facts which change together in the same direction.
14. State five examples of facts which change together in opposite directions.
15. What advantages do you expect to derive from the study of economics?
16. Does economics teach people how to succeed in business? Give reasons for your answer.
17. Do all of the pupils in your class answer these questions equally well?  
Why or why not?
18. Are there slums in your city? Is it the aim of economics to correct slum conditions?
19. Does an increase in the wealth of the country improve the moral fabric of the people? Cite examples in support of your answer.

## CHAPTER II

### CONSUMPTION

**The Wants of Man.** Man has needs and wants which cover a multitude of goods and services. These needs and wants are at the starting point of economic activity. If there were no wants to be satisfied there would be no work; nothing would be produced. Needs and wants, demanding satisfaction through goods and services, prompt man to overcome all obstacles such as fatigue, laziness, ignorance and other natural difficulties of production.

These wants are far more numerous than the many varieties of goods and services offered on the market to satisfy them. A list of human wants which would include everything bought and sold would fall far short of being complete. Thousands of articles which will sweep the market when introduced are still to be invented. A flying machine, cheaper, faster and safer than the aeroplane, would no doubt find a ready market because there exists a want for cheap, safe and fast transportation. Myriads of wants which man develops will likely for ever go unsatisfied in this world. Man has infinite desires but his want-satisfying power is, unfortunately, limited.

**Origin of Human Wants.** Our wants for food, shelter and clothing are implanted in us by nature. Our wants for certain styles in food, shelter and clothing are imposed upon us by custom and fashion. Customs are more or less permanent habits which extend to all the members of a group forming a community. Fashion is the fleeting, transient vogue which often begins to disappear before it is fully introduced. Seeing what the neighbour eats, and wears, drives in and lives in, is a powerful stimulant for the growth of new cravings. Fashions are usually set by great style centres such as Paris for women, and London for men, or by celebrities who hire publicity agents to keep them prominently in the public mind.

Salesmanship is also an important factor in the creation of desires for new goods and services. Newspaper and magazine advertising, radio talks, door to door canvassing and mail circulars educate people to new standards. Psychology is applied extensively to stimulate desires for the recent creation of the laboratory and the designing studio. Education increases the number of wants by improving culture and civilization.

**Kinds of Wants.** Wants may be classified according to the degree of necessity and according to the nature of the things wanted.

- A. According to the degree of necessity of the things wanted.
  - 1. Wants for necessities, such as food, clothing, housing, education, security and self-respect.
  - 2. Wants for comforts, such as an easy-chair, a fur-lined overcoat, an automatic furnace.
  - 3. Wants for luxuries, such as diamonds, cosmetics and lace curtains.
- B. According to the nature of the things wanted.
  - 1. Wants for material things, such as food, shelter, automobiles.
  - 2. Wants for intangibles, such as leisure, security and self-respect.

**The Satisfaction of Human Wants.** Wants are satisfied by the destruction of goods and by receiving personal services such as are performed by the doctor, the teacher, the lawyer and the barber. Only those goods which, through production, have acquired utility of form, place, time and possession are capable of satisfying wants. Coal will burn as well at the mine as in a furnace, but it must be broken up into lumps of the proper size, it must be transported, it must be stored in the bin till needed, and it must become the property of the user before it can satisfy his wants. All things capable of satisfying wants have utility. Hence, utility is the capacity of a thing to satisfy human wants. When wants are satisfied with produced goods, the utility of the goods is destroyed. This is consumption, the opposite of production, which is the creation of utilities. Consumption is the destruction of utilities, with the object of satisfying human wants.

**The Laws of Consumption.** An economic law is the tendency of certain events to repeat themselves under similar conditions. In consumption there are four such laws.

1. *The Law of Diminishing Utility.* In the consumption of a box of chocolates the first unit consumed gives intense satisfaction. The second unit, still very pleasant to the palate,

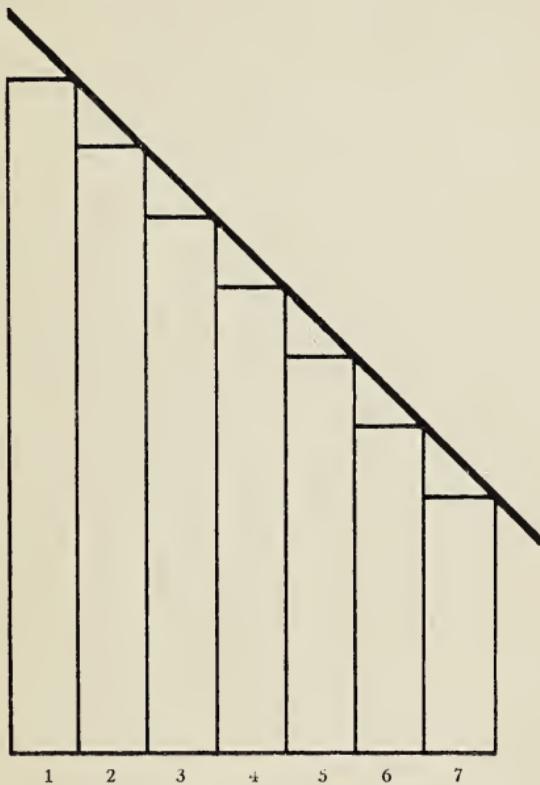


FIG. 2. LAW OF DIMINISHING UTILITY

gives slightly less satisfaction. With the third unit the desire for chocolates begins to pall. Each successive unit dulls the desire for more chocolates. Here is an event which occurs not only in the consumption of chocolates, but also in the consumption of all goods.

We state this law as follows: In the consumption of a series

of identical goods, each succeeding unit provides less satisfaction than the preceding one.

2. *The Law of Harmony.* Certain groups of sounds reaching the ear at the same time give the impression of noise; other groups of sounds intelligently blended are known as music. Likewise certain goods clash and jar when consumed together. They produce indigestion, ugliness or some other fault. Other groups give pleasing results and this to a much greater degree than if the goods were consumed separately. Many such harmonious combinations of goods may be found in various books ranging from the family cook book to the elaborate fashion catalogues published for retail distributors of wearing apparel. All of them illustrate the following law: Right combinations of goods procure greater satisfaction than wrong combinations.

3. *The Law of Variety.* Our wants are very numerous. The greater the number of wants satisfied, the greater is the aggregate satisfaction. Dietitians have calculated that a man with moderately active work requires approximately 3,400 calories per day, of which two calories per pound of body weight must be protein calories. These requirements can be met with two twenty-four-ounce loaves of bread per day. This is the diet fed to unruly prisoners in penitentiaries. It keeps body and soul together, but beyond this it provides very little satisfaction. It leaves too many wants ungratified. The law of diminishing utility applies here and renders consumption very monotonous.

The law of variety may be stated thus: Variety in consumption increases satisfaction.

4. *Engel's Law.* Ernst Engel, 1821-1896, a German economist of note, made a study of family budgets. He found facts which agree with experience in Canada. He discovered that a family spends an increasing part of its income for comforts and luxuries as it rises in the social scale. This law of family expenditure may be stated as follows: As the income of a family increases, the percentage expenditure for food decreases; that for clothing, rent, fuel, and light remains approximately the same; and that for cultural needs increases.

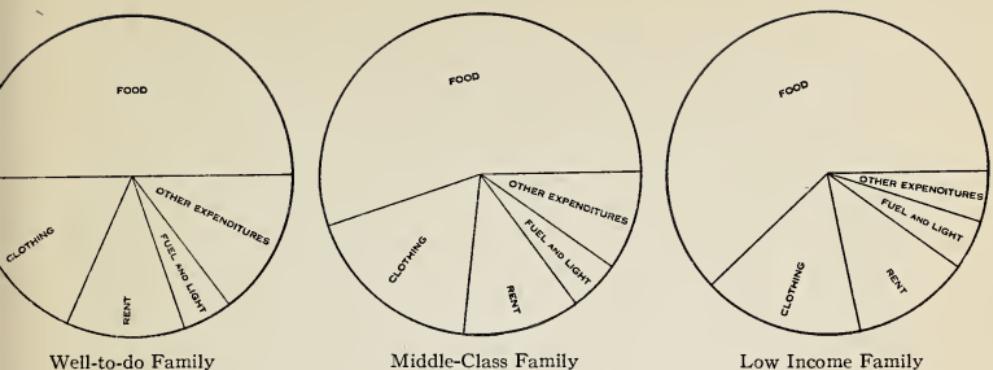


FIG. 3. ENGEL'S LAW.

**How Much Shall We Consume?** Consumption is limited in many ways. The consumer's money income largely determines the amount of goods and services he consumes. Money income is what is received in wages, salary, interest, dividends, rent and royalties. Prices determine how much each member of the community may buy with his money income. If prices rise the same money income will buy less; if prices fall the same money income will command more goods and services.

Consumption is limited also by the consumer's physical capacity. We can wear only one suit of clothes, we can eat only one meal, we can see only one theatrical performance at one time. Moreover, after consuming a certain quantity of goods, the want which prompted the consumption of these goods is satisfied, and consumption will not be resumed until the want recurs. A hearty meal destroys the desire for food. After an interval of a few hours hunger reappears and more food is consumed.

A people which consumes a large volume of goods and services has a high standard of living. Where food is scarce, clothing hard to obtain, and housing of a primitive type, the standard of living is said to be low. A high standard of living goes hand in hand with a highly developed and well rounded culture. The standard of living varies from country to country, from place to place within the same country, and from time to time.

**Choice.** The market offers a wide variety of goods from which the buyer may choose the commodities which will best satisfy his wants. All producers are in open competition to secure for themselves as large a share as possible of the consumers' dollars. In fact, the consumers' dollars come from the producers who paid them out as their cost of production. Obviously the producers must take back these dollars by making sales or be forced into bankruptcy. They all put money into circulation when they produce goods; all of them must get back their share of this money to remain in business.

This means an endless game of wits between producer and consumer. The producer knows that the way to get the consumers' dollars is to guide choice-making. Obviously, this guidance is not always to the consumers' advantage. They are threatened, compelled, persuaded, coaxed, to choose a certain product. Salesmanship and its ally, advertising, exist for the main purpose of directing consumers to buy certain commodities.

#### EXERCISES AND PROBLEMS

1. Why do we say that needs and wants are at the starting point of economic activity?
2. Make a list of those human wants which you consider to be most important.
3. What is the origin of our wants for food, shelter and clothing?
4. What are customs?
5. What is fashion?
6. What are the necessities of life?
7. What are the comforts of life?
8. What are the luxuries of life?
9. Make a list of goods which you consider necessities in your case.
10. What is utility?
11. In the following statement: "Bread has more value than gold," what scientific word would you use instead of the word "value"?
12. What is consumption?
13. Is feeding corn to hogs consumption?
14. Is wearing a pair of gloves at work in a factory consumption or production?
15. State and illustrate the following laws:
  - (a) The law of diminishing utility.
  - (b) The law of harmony.
  - (c) The law of variety.
16. Obtain budgets for your community and compare them with Engel's results.
17. What is the measure of the standard of living?
18. Define culture.
19. State five factors which affect your choice-making when you shop in a department store.

## CHAPTER III

### PRODUCTION

**What Is Production?** When we say that consumption is the destruction of utility we do not mean that consumption destroys matter. Man cannot destroy or create matter; he can only change its form. Man can make matter capable of satisfying human wants by changing its form, by transporting it to the place of consumption, by preserving it until the time of consumption, and by transferring it from the producer to the consumer. Expressed in a simple way, production is the creation of utilities.

*Elementary Utility.* Nature supplies articles which possess a usefulness that is not the result of human effort. Their usefulness is nature's free gift to man. All raw materials used by industry have properties which make them suitable for consumption when manufactured. Iron ore, for instance, has natural properties which make it capable of withstanding tremendous stresses and strains after it has been subjected to the proper industrial processes. These natural properties give iron ore its elementary utility which may be defined as the utility which a thing possesses by reason of its properties of natural origin.

*Form Utility.* The new form which raw materials acquire by going through industrial processes means added utility. This new capacity to satisfy wants does not exist before manufacturing. Labour, aided by machinery and by the forces of nature, brings out in raw materials certain properties which render them more useful. Since this work of changing raw materials into finished products consists mainly in changing the form of goods, the utility thus acquired is called form utility. Form utility is the utility which a thing possesses by reason of its properties of artificial origin.

*Place Utility.* Our Canadian wheat, grown in the Western Provinces, is of such quality that it has won the annual Inter-

national Wheat Prize twenty times in twenty-four years. This means that it has more utility than the wheat of any other country. Still, if means of transportation were lacking, this choice product would not be available to consumers of Canadian wheat living in many distant places throughout the world. The same applies to our nickel and asbestos, which enjoy a world-wide distribution. Transportation makes goods useful by carrying them from the producer to the consumer. Place utility is that utility which an article has when it is in a place convenient to the user.

*Time Utility.* Many commodities, such as agricultural products, are produced only at a certain season to be consumed throughout the year; other goods, such as anthracite coal, are produced throughout the year to be consumed during a certain season. In either case the goods have to be kept over a period of time. Goods that have been so kept have acquired time utility. Time utility is that utility which an article has when it is present at a time convenient to the consumer.

*Possession Utility.* In an economic system, such as that under which we live, the individual is engaged in the production of a small number of goods in large quantities while he consumes a large number of commodities in small quantities. He therefore must exchange his surplus for those goods which he does not produce. Exchange consists in transferring ownership from one person to another. When the ownership of goods is so transferred, and they are ready for consumption, the goods have a greater utility than those which have not been exchanged. They have possession utility, the utility which goods have by reason of being in the consumer's possession.

**Wealth.** Nature supplies certain useful things in abundance sufficient to remove all desire of owning them. These goods are called free goods. However, most things capable of satisfying human wants derive their utility from production and have enough desirability to make them worth owning. These goods are called economic goods and when considered in the aggregate they are called wealth.



FIG. 4. AGRICULTURE



FIG. 5. AN EXTRACTIVE INDUSTRY

Wealth must not be confused with money. This is a common error and should be studiously avoided. The confusion arises from the fact that wealth is measured in terms of money, that is, in dollars, pounds, francs, etc. All money is wealth, but not all wealth is money.

Wealth differs, as well, from property. Property, or ownership, is the right to use wealth and the goods and services derived from it. Obviously, the right to walk over a path is not the same as the path itself. In measuring wealth care must be taken not to confuse wealth and property. If we are measuring the wealth of the country we may count only the physical, tangible possessions. The total arrived at after taking a material inventory represents the true total of the national wealth. To add to this the value of stocks, bonds and land titles held in the country would be to count the same thing twice.

The easiest way of distinguishing wealth from free goods is to apply the money test. Of an article, ask the question, "Can I get money for it?" If the answer is *yes*, it is wealth; if the answer is *no*, it is a free good.

**The Industries.** The extractive industries are those which provide the raw materials of production. Farming, fishing, grazing, hunting, trapping, mining, quarrying, and the gathering of wild saps, nuts, gums, fruit and herbs are extractive industries. They are sometimes called the basic or primary industries, from which title we draw the terms basic products or prime products. Their task is to exploit the natural resources and to supply the manufacturing industries with a steady flow of raw materials.

The manufacturing industries are not concerned solely with changing the form of raw materials. The industrial processes cover a multitude of operations such as: alloying, assembling, baking, blending, compounding, dyeing, flavouring, mixing, painting, plating, sewing, veneering, weaving and welding, operations which bring together various materials; boring, cutting, distilling, drilling, drying, husking, purifying, reaming, screening, shelling and smelting, operations which remove undesirable parts from the material under manufacture; crushing,

milling, pulverizing, and shredding, which break the material into smaller units; casting, embossing, moulding, planing, pressing, stamping, shrinking and stretching, which change the shape and size of the material; and annealing, crystallizing, fermenting, freezing, hardening, liquefying, melting and tempering are only a few among a great many miscellaneous operations.

Transportation, more than any other industry, has made possible the development of our economic system. Without transportation there can be no geographical specialization. Our chief agencies of transport are those which carry goods over water, inland or ocean, the railways, vehicles using highways, aeroplanes, pipe-lines and power-transmission lines. The telephone, the telegraph and wireless are also associated with transportation.

The storage industry is conspicuous in Canada by the number and size of elevators which stand like sentinels over the prairie, or give an air of commercial greatness to our ports. Warehousing and cold-storage are important branches of this industry.

Merchandising or marketing includes all those business operations which are necessary to transfer the ownership of goods through the various stages of production from the primary producer to the consumer. Wholesale and retail establishments, organized commodity markets, such as the Winnipeg Grain Exchange, and other buying and selling agencies are necessary merchandising institutions.

**The Factors of Production.** Man, to produce goods, must have at his disposal land or raw materials supplied by nature. Although this combination of human labour and the natural elements produces results, man, by his mental exertion, discovers new methods which yield better results. He invents tools and machinery, he discovers the properties of the natural elements, he harnesses the forces of nature to supplement the limited power of his muscles and he organizes his fellow men into groups which multiply the output by pooling individual abilities.

Consequently, production is the result of the co-ordination of labour, nature and man-made means of increasing the output.



FIG. 6.—HIGHWAY TRANSPORTATION

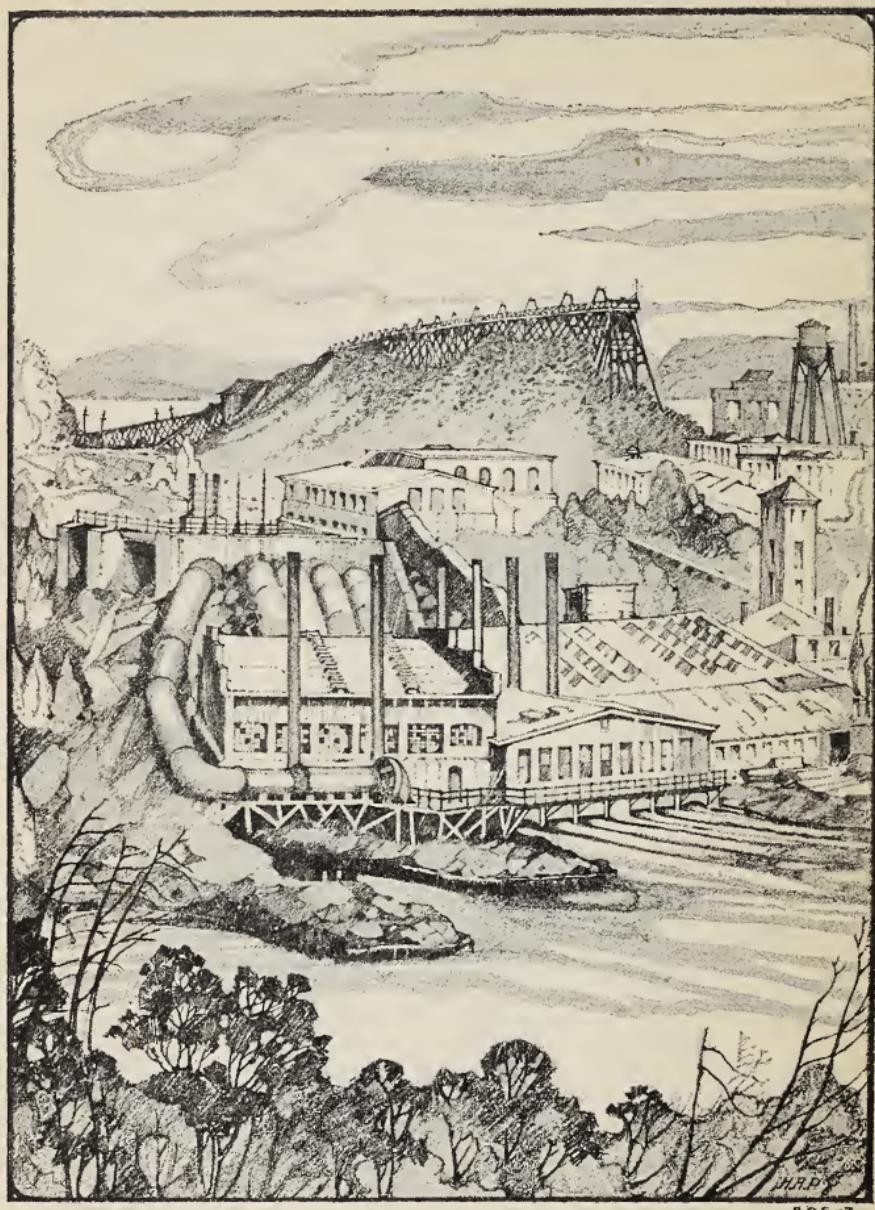


FIG. 7. MANUFACTURING—A PULP AND PAPER MILL

These man-made means are called capital. Thus, there are three factors of production; nature or land, labour and capital.

**The Measurement of Production.** There are two methods of measuring production. One method is to measure the physical volume of the goods to which utilities have been added by productive processes. The units of measurement are those generally used in business. Thus, we can determine the rise and fall of production in any given line by counting the actual numbers, yards, tons, or cubic feet, produced over a certain period of time. The results are stated in thousands of kilowatt hours or carloadings, millions of bricks, ounces of gold, tons of steel or bushels of grain.

Another method of measuring production is in terms of the money unit, in dollars and cents, pounds and shillings, francs and centimes. All goods produced have a market value and are, therefore, measurable in terms of their prices. However, this method has its drawbacks for the obvious reason that price changes are always taking place.

With the first method it is impossible to obtain a standard of comparison between the various lines of production. The second method supplies a means of comparing the production of the various lines, but only in terms of a yardstick which lengthens and shortens as prices fall and rise. A device called the index number is used to remedy these defects.

**Index Numbers.** The index number is a number which expresses the relationship between two quantities of which one is taken as the base and is represented by the number 100.

Table 1 shows the actual number of carloadings. In Table 2 this is expressed by means of index numbers. The base, here, is the average monthly number of cars loaded in the year 1926, which is taken as equal to 100. Numbers in Table 2 are index numbers which express the relationship between the number of cars loaded in each of the months which they represent and the average monthly number loaded in 1926.

With the aid of index numbers we overcome the difficulty

which every one meets in comparing large numbers. There is also a decided advantage in establishing a common basis of comparison. This base serves as a yardstick for measuring the fluctuations which occur in the periods under study.

TABLE 1  
CARLOADINGS  
(In thousands)

Year	Jan.	Feb.	Mar.	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1919..	197.6	186.5	211.1	182.0	200.9	210.1	209.5	216.0	276.0	334.9	292.9	224.5
1920..	214.1	203.1	225.1	194.8	212.7	227.9	241.9	229.5	266.0	294.0	279.1	238.4
1921..	191.0	164.7	180.3	171.4	181.3	201.6	196.5	218.8	241.1	260.6	200.6	174.9
1922..	170.6	160.8	201.3	169.5	211.7	220.4	238.8	245.7	305.3	314.2	285.0	204.7
1923..	211.3	174.2	211.3	214.4	235.8	238.4	220.2	237.4	262.0	326.1	295.0	232.2
1924..	211.3	216.7	250.8	229.5	250.7	241.7	228.1	215.5	254.4	318.6	278.7	219.9
1925..	225.0	215.4	228.2	213.0	214.8	219.3	243.8	260.9	323.4	334.6	318.3	270.0
1926..	227.6	223.0	246.0	238.0	261.5	269.7	268.7	257.1	303.8	355.2	337.0	279.4
1927..	243.8	242.2	284.1	256.4	259.4	273.7	260.1	282.8	304.3	360.2	344.8	286.8
1928..	265.5	267.1	285.6	252.1	300.3	294.5	290.7	312.8	361.2	420.3	380.4	275.7
1929..	252.2	261.4	282.3	283.7	306.7	310.9	313.3	318.2	335.3	353.1	284.7	230.6
1930..	241.6	231.5	257.5	243.8	278.6	269.0	264.2	281.1	302.9	308.0	250.2	204.9
1931..	204.0	190.2	210.5	214.4	216.0	221.9	207.0	205.5	226.5	265.0	230.9	185.0
1932..	165.8	174.1	186.0	180.2	182.7	185.2	157.4	175.6	215.7	211.5	192.6	152.6
1933..	134.4	133.1	157.4	138.5	161.4	176.0	162.7	185.6	202.5	221.6	201.4	157.6
1934..	176.4	164.1	189.2	177.2	194.1	193.4	187.9	204.6	212.2	242.9	211.1	171.6

TABLE 2  
INDEX NUMBERS OF CARLOADINGS  
1926 = 100

Year	Jan.	Feb.	Mar.	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1919..	82.4	81.2	82.9	78.0	78.3	79.7	80.6	79.0	87.1	94.7	91.4	85.8
1920..	89.3	88.4	88.3	83.5	82.9	86.5	93.0	84.0	84.0	83.1	87.1	91.1
1921..	84.6	80.4	75.3	69.0	66.4	72.9	71.3	81.6	86.2	84.4	74.9	74.8
1922..	68.2	70.8	78.0	62.5	70.0	74.3	78.7	78.7	102.0	102.1	101.1	84.4
1923..	88.1	75.8	82.9	91.9	91.9	90.5	84.7	86.9	82.8	92.2	92.1	88.8
1924..	88.1	94.3	98.5	98.4	97.7	91.7	87.8	78.9	80.3	90.1	87.0	84.1
1925..	93.8	93.7	89.6	91.3	83.7	83.2	93.8	95.5	102.1	94.6	99.3	103.2
1926..	94.3	97.1	96.5	102.0	101.9	102.4	103.4	94.1	95.9	100.4	105.2	106.8
1927..	101.7	105.4	111.5	109.9	101.0	103.9	138.5	103.5	96.0	101.8	107.6	109.6
1928..	110.7	116.3	112.1	108.1	117.0	111.8	111.6	114.5	114.0	118.8	118.8	105.4
1929..	105.1	113.8	110.8	121.6	119.5	118.0	120.5	116.4	105.8	99.8	88.9	88.2
1930..	100.7	100.8	101.1	104.5	108.5	102.1	101.6	102.9	95.6	87.1	78.1	78.4
1931..	85.1	86.5	82.6	91.9	84.1	84.2	79.6	75.2	71.5	74.9	72.1	70.7
1932..	69.1	75.8	73.0	77.2	71.2	70.3	60.5	64.3	68.1	59.8	60.1	58.4
1933..	56.1	57.9	61.8	59.4	62.9	66.8	62.6	67.9	63.9	62.6	62.9	60.4
1934..	73.6	71.4	74.3	76.0	75.6	73.4	72.3	74.9	67.0	68.7	65.9	65.7

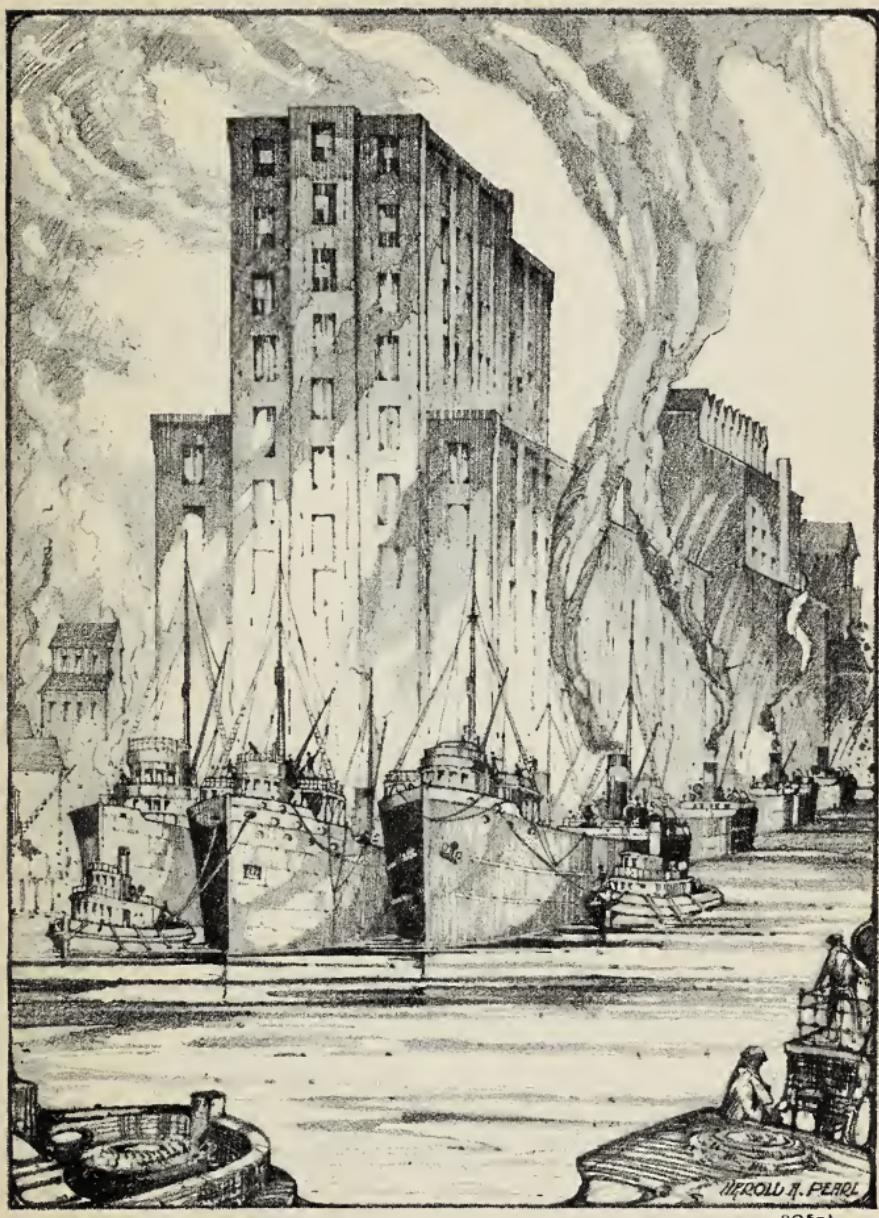


FIG. 8. STORAGE—GRAIN ELEVATORS

Evidently, this method of comparing quantities may be extended to all economic factors which can be measured, and which are subject to change, such as prices, wages, rate of interest, bank debits and employment. They are especially useful in representing changes which take place in a group of economic factors. If we wish to measure the physical volume of Canada's business, we may combine a group of index numbers into a single number. The index of the physical volume of business published by the Dominion Bureau of Statistics is an example of a composite index. The large number of items which are used in preparing this index number makes it representative of general business conditions throughout the country.

TABLE 3  
COMPARISON OF THE BUSINESS INDEX WITH SIX  
OF ITS COMPONENTS

Year	Physical Volume of Business	Industrial Production	Mineral Production	Manufactures	Construction	Electric Power	Distribution
1919.....	71.3	65.5	55.8	71.0	56.2	44.4	87.2
1920.....	75.0	69.9	68.0	70.7	75.2	49.0	89.2
1921.....	66.5	60.4	57.6	60.1	70.0	41.3	83.5
1922.....	79.1	76.9	69.4	75.4	92.4	51.3	85.0
1923.....	85.5	83.8	76.8	86.2	85.0	66.3	89.9
1924.....	84.6	82.4	78.9	84.7	79.6	70.3	90.7
1925.....	90.9	89.7	86.3	92.5	82.6	82.8	93.9
1926.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1927.....	106.1	105.6	109.5	100.8	118.6	119.1	107.4
1928.....	117.3	117.8	116.3	113.0	133.8	133.3	116.2
1929.....	125.5	127.4	123.4	117.7	164.1	148.0	120.5
1930.....	109.5	108.0	116.3	98.0	129.7	150.0	114.0
1931.....	93.5	90.4	100.5	84.6	91.2	137.5	102.3
1932.....	78.7	74.0	93.2	74.0	43.1	132.7	91.9
1933.....	79.7	76.8	96.1	79.9	26.3	147.2	87.7
1934, Jan.....	86.8	84.5	120.6	80.7	47.4	162.9	93.2
Feb.....	86.4	84.0	117.0	83.2	34.1	168.9	93.1
Mar.....	93.1	92.0	149.0	88.8	36.2	176.0	96.3
April.....	92.6	91.4	160.2	87.7	28.9	176.7	96.0
May.....	99.6	99.9	146.3	100.2	35.1	188.5	98.5
June.....	95.8	95.2	127.3	98.7	25.7	185.7	97.5
July.....	95.7	95.6	117.2	99.0	35.5	180.6	96.2
Aug.....	99.0	99.8	135.7	100.7	40.7	184.8	96.7
Sept.....	97.1	97.5	132.7	99.5	41.3	162.7	96.2
Oct.....	95.9	95.5	143.5	94.8	38.1	170.4	97.2
Nov.....	96.5	97.0	137.5	96.0	43.1	181.4	95.2
Dec.....	92.4	91.0	121.8	91.8	31.2	188.8	96.1

*Making Index Numbers.* The task of preparing these numbers is most difficult. Trained statisticians are generally employed to make computations from reports from all over the country. They employ long and intricate formulas designed to arrive at an index representative of actual conditions. The use of index numbers, fortunately, is not limited to those who have acquired a knowledge of higher mathematics. They are easily understood by all and they are indispensable to students of business and financial current events.

*Canadian Index Numbers.* Index numbers are prepared by the Dominion Bureau of Statistics at Ottawa, and published in the *Monthly Review of Business Statistics* and the *Canada Year Book*. Every student of economics should obtain copies of these publications or consult them in the public library. The Bureau of Statistics also publishes a number of weekly, monthly, and yearly reports, a list of which may be obtained upon request. Other useful index numbers may be found in the *Labour Gazette* published by the Department of Labour, Ottawa.

**Graphs.** A table of numbers does not always yield at first hand all the desired information. Many changes and contrasts are obvious only to the trained observer, while they escape the attention of the average person. It is possible, however, to present practically any kind of numerical data in a form which reveals at a glance the secrets of the column of statistics. By means of diagrams, charts or graphs many facts are made clear. There are several forms of diagrammatic presentation. The principal kinds are: the line graph, the circular chart, the horizontal bar, the paired horizontal bars, the vertical bar and the paired vertical bars. The following is a line graph of carloadings in Canada.

#### EXERCISES AND PROBLEMS

1. What is production?
2. What is elementary utility?
3. What is form utility?
4. What is place utility?
5. What is time utility?
6. What is possession utility?

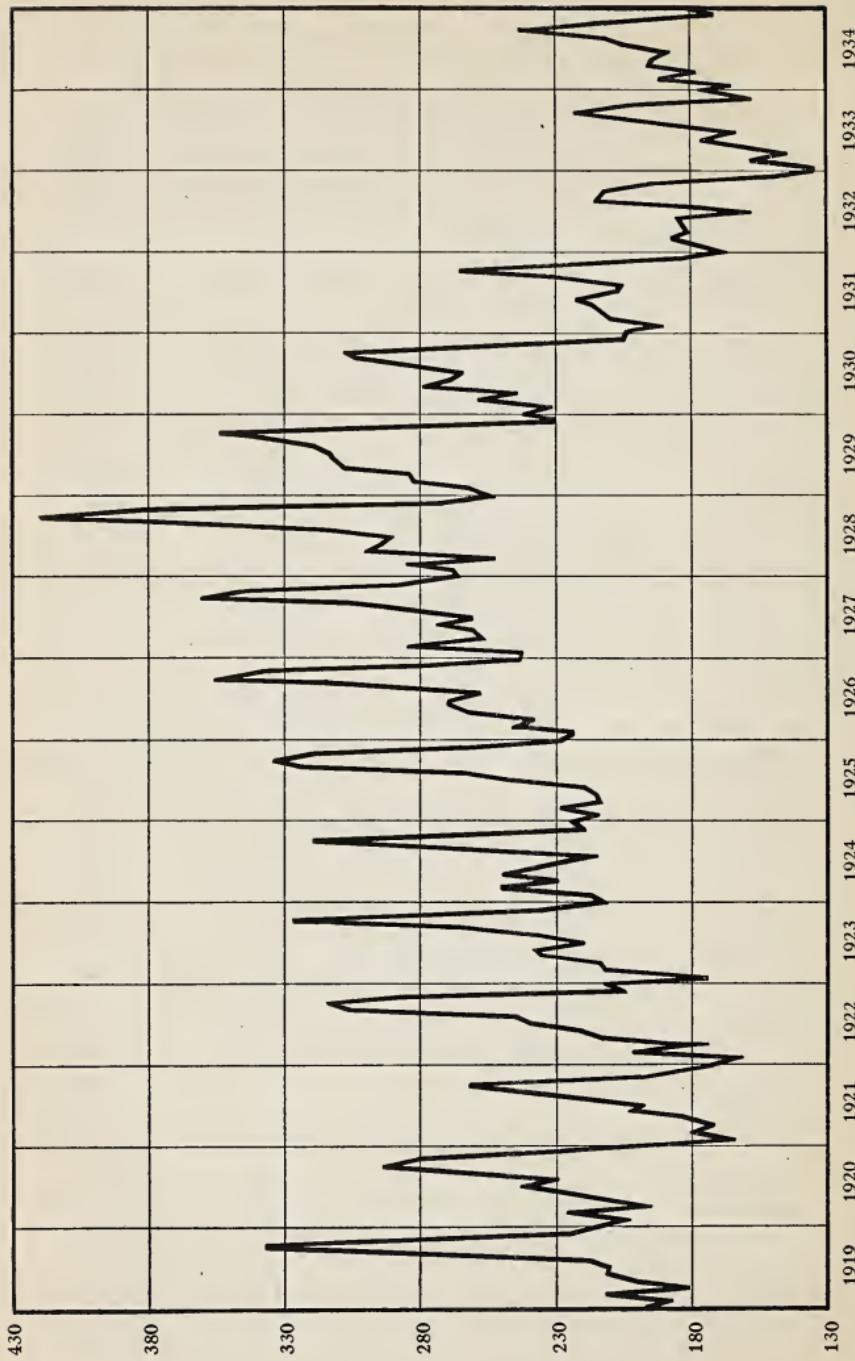


FIG. 9. CARLOADINGS  
(thousands of cars per month)

7. What is wealth?
8. When silver is selling at fifty cents an ounce the silver in a fifty-cent piece is worth fifteen cents.
  - (a) Is a fifty-cent piece wealth?
  - (b) Is a fifty-cent piece worth more as money than as wealth?
9. What is property?
10. What are the primary industries?
11. What utility is created by each of the following:
  - (a) Manufacturing?
  - (b) Transportation?
  - (c) Storage?
  - (d) Merchandising?
12. Name and classify ten industrial processes.
13. Why must production be measured?
14. In 1929 Canada produced 304,520,000 bushels of wheat which had a sales value of \$319,715,000 and in 1930 produced 420,672,000 bushels which had a sales value of \$204,693,000. In which year was production the larger?
15. What are index numbers?
16. What advantages are derived from the use of index numbers?
17. Draw a line graph of the index of carloadings.
18. Why is the money unit a poor yardstick with which to measure production?
19. Collect newspaper articles and graphs describing changes in the volume of production.
20. Describe the importance of an accurate index of the volume of production to the statesman, the banker, the manufacturer and the importer.

## CHAPTER IV

### THE ENTERPRISER

**The Enterpriser.** Anyone who controls and manages a productive enterprise is called an enterpriser. The productive enterprise may be a farm, a mine, a store, a factory, a transportation system. In production the enterpriser has definite functions to perform. He may be the founder of a new enterprise or he may have taken over a going concern. Upon him is thrust the burden of risk. No concern, however prosperous, is free from the dangers of failure. The enterpriser risks his funds and his reputation as a manager. He has the responsibility of making decisions in the management of the enterprise, the soundness of which decisions determines the success or failure of the business he directs.

**Forms of Business Enterprise.** Some enterprisers stand out alone to carry on production. Other enterprisers join together to form partnerships, corporations or co-operative enterprises. This gives rise to four types of business enterprise.

1. The single enterprise.
2. The partnership.
3. The corporation.
4. The co-operative enterprise.

*The Single Enterprise.* In this form of business organization one individual assumes alone the responsibility of managing the enterprise. He is the owner and he, consequently, draws all profits. As manager he hires his own helpers, buys his own plant, machinery and equipment, rents or buys land, and sells his own product. Typical examples of single enterprisers are the farmer, the barber and the small manufacturer. In spite of the generally limited size of individual enterprises there are definite advantages attached to them. The single enterpriser will, as a rule, do his best because he gets all the profits. He is also his own

boss and the size of his enterprise allows him to maintain close personal relations with his employees. However, he generally lacks capital and he is subject to errors in judgment which could be avoided in a more extensive organization.

*The Partnership.* When two or more individuals agree to conduct a business together they form a partnership. The agreement may be written or oral. The written agreement is called a partnership contract. In this contract are set out the amount invested by each partner, the duties to be performed by each, and the arrangement for profit-sharing. Partnerships often bring together various kinds of skill. This blending of skills into the same business organization is of great advantage. Partners divide all of the profits among themselves and therefore are more interested in increasing profits than if they were paid wages. Capital is available to a partnership more readily than to a single enterprise. These advantages are unfortunately cancelled by certain disadvantages which tend to remove this form of business organization to the background of the business world.

*Disadvantages of the Partnership.* 1. Partners are jointly and severally liable. This means that each of the partners may be sued by any of the firm's creditors for any debt incurred by the firm. Suppose that Brown, Doe and Jones enter into a partnership to manufacture hats. A change in the style of hats leaves them with assets of \$50,000 and liabilities of \$75,000. Suppose, further, that both Brown and Jones are penniless and that Doe owns a beautiful home. Doe may be sued for \$25,000 owed by the firm and be forced to sell his home. Of course Doe has a right to sue Brown and Jones for their part of the liability and he could exercise this right if they became able to pay and refused to do so. This unlimited liability feature of the partnership is its most serious disadvantage.

2. Mental disability of a partner ends the partnership.
3. The death of a member of the firm also dissolves the partnership.

4. Disagreements on serious matters of policy may hamper the firm's progress.
5. The ability to get capital and credit is limited by the financial standing of the partners.
6. No partner may withdraw without the consent of the other partners.

*Why Liability should be Limited.* Single enterprisers and partners always have to face the possibility of losing all they own. Indeed, the prospects of loss are often surer than the prospects of gain. In case of failure they stand to lose not only their investment in the insolvent enterprise but their private property as well. This unlimited liability has the undesirable tendency of discouraging the launching of new enterprises. The size of the productive unit is of the utmost importance. A large undertaking can turn out more goods with less labour. Large units are impossible unless many investors pool their funds. In the partnership type of enterprise this is utterly impractical. The liability of each investor is too great. Some form of business enterprise that will allow investors to pool their resources without fear of being held responsible for large debts in case of insolvency must be organized. This third type of business organization is the corporation.

*What is a Corporation?* A corporation, or an incorporated company, is an artificial person created by law for a specified purpose. It is called an artificial person to distinguish it from individual human beings who are said to be natural persons. The life of a corporation begins when the government grants a charter to a group of enterprisers allowing them certain powers to attain a certain purpose written into the charter. The law gives the corporation an existence of its own apart from the individuals who organize it or who become members of the group forming the corporation. It is a legal entity and as such it may enter into contracts in its own name and it may sue in court and be sued like any natural person. It ceases to exist only when the charter is surrendered to the government. The death of its members does not dissolve the corporation.

*Kinds of Corporations:*

1. Municipal.
2. Stock.
  - (a) Moneyed.
  - (b) Transportation.
  - (c) Business.
3. Non-stock.
  - (a) Religious.
  - (b) Membership.

1. Municipal corporations are subdivisions of the province established by law with powers of local government; examples are cities, counties, and townships.

2. A stock corporation is a corporation having a capital stock divided into shares and which is authorized by its charter to divide between the stockholders the surplus profits of the corporation.

(a) A moneyed corporation is one engaged in purely financial operations, such as banks, insurance companies and mortgage loan companies. They are often regulated by special acts.

(b) Transportation companies are those which carry goods and passengers such as railway and steamship companies.

(c) Business corporations comprise all the other corporations engaged in commercial and industrial enterprises.

3. Non-stock corporations include churches, charitable institutions, educational corporations, clubs, etc.

*The Stockholders.* They are the owners of the corporation. They own, among themselves, the capital stock of the corporation. To simplify the distribution of ownership the capital stock is divided into shares which are taken up partly by the promoters of the new enterprise, and partly by the public. In certain cases the stock is not offered to the public. As owners of the corporation stockholders have the following rights and powers.

A. Rights of stockholders.

1. To receive dividends which are a division of the surplus profits according to the number of shares outstanding.
2. To be notified of stockholders' meetings which they may



FIG. 10. A STOCK CERTIFICATE

attend in person or by proxy and at which they may cast as many votes as they own shares.

3. To receive a proportionate share of the net worth in case of dissolution.

4. To inspect certain books and records.

B. Powers of stockholders.

1. To pass new by-laws and to modify or repeal existing by-laws.

2. To choose directors.

3. To vote on charter amendments, entire sale of assets and surrender of the charter.

*The Directors.* To allow all the stockholders to take an active part in managing the corporation would be unsatisfactory. Management must be centralized. This is done by electing a board of directors to whom the stockholders delegate some of their powers. The directors in turn name the officers who are to be entrusted with the active management: the president, the vice-president, the secretary, and the treasurer. Many corporations have, as well, several vice-presidents, a general manager, and a permanent counsel.

*Advantages of the Corporation.* The outstanding advantage of the corporate form of business enterprise is the limitation of the investor's liability. This and the fact that shares of capital stock are transferable, that is, may be sold by the stockholder, enables the corporation to attract capital in amounts sufficient to operate on a large scale and with all the advantages of mass production.

*The Co-operative Form of Business Enterprise.* Under any form of business organization there are three things to be distributed: ownership, management and profits. In the three types of business enterprise previously studied the profits are shared among the owners. Profits, in the co-operative enterprise, are distributed among those who use the enterprise. A co-operative retail store distributes profits to buyers according to the volume of purchases. The organization of a co-operative unit differs from that of the corporate unit in many respects.

The number of shares of capital stock which any individual may own is limited, and the stock is not transferable without the consent of the board of directors. At general meetings the stockholder has only one vote regardless of the number of shares he may possess. Voting by proxy is generally prohibited.

*Kinds of Co-operative Enterprises:*

1. Consumer.
2. Producer.
3. Marketing.
4. Credit and savings.
5. Community hall and miscellaneous.

*Co-operation in Canada.* Co-operative enterprises have existed in Canada since 1861 when the first Canadian co-operative store was opened at Stellarton, Nova Scotia. This principle was brought over from England. It dates back to the organization of the "Equitable Pioneers of Rochdale," an enterprise launched by twenty-eight weavers of that town in 1844. To-day this type of organization is known from coast to coast.

**Government Enterprise.** The Canadian National Railways, the Post Office, the Government Printing Bureau, the Royal Canadian Mint, the telephone systems of Alberta, Saskatchewan and Manitoba, the Ontario Hydro-Electric System, are examples of government enterprises. The chief characteristic of this type of business organization usually is that it gives service at cost after making provision for reserves. Government enterprises may be owned by the municipality, by the province or by the Dominion. The Ontario "Hydro" is an association of municipalities.

Governments go into business when certain services are urgently needed and are not provided by private enterprise, when corporations are compelled by financial stringency to discontinue essential services and, finally, when competition is impossible, as in natural monopolies.

When government enterprise is the only form of business organization it is called Communism. This is the U.S.S.R.

system. The corporative state system of government enterprise, as practised in Italy, respects the principle of private ownership of property and private enterprise while it helps and regulates industry, agriculture, commerce, banking and the crafts.

#### EXERCISES AND PROBLEMS

1. Who is the enterpriser?
2. What are the functions of the enterpriser?
3. Name ten productive enterprises.
4. Name four forms of business enterprise.
5. What are the advantages and the disadvantages of the single enterprise?
6. What is a partnership?
7. What are the advantages and the disadvantages of the partnership form of business enterprise?
8. Why must the enterpriser's liability be limited?
9. What is a corporation?
10. Classify the various kinds of corporations.
11. What is a municipal corporation?
12. What is a stock corporation?
13. What is a moneyed corporation?
14. What are the rights of stockholders?
15. What are the powers of the stockholders?
16. Name twenty directors of corporations.
17. What are the advantages of the corporate form of business enterprise?
18. How are profits divided in the co-operative enterprise?
19. Describe the development of co-operation in Canada.  
(Consult the *Canada Year Book*.)
20. What are the advantages of government enterprise?

## CHAPTER V

### LAND

**Definition.** Land, in the terminology of economics, includes all natural resources. To avoid confusion with the common meaning of the word land, the term "natural agents" is used; this term not only includes natural gifts of animal, vegetable and mineral origin; it extends to the productive forces of nature, such as the force of gravity, the expansive force of gases, cohesion, magnetic attraction and repulsion.

**The Uses of Land.** Land is the source of all raw materials. Land provides sites on which are erected buildings and over which are spread rails, pavements, pipe-lines, and mazes of power transmission and communication wires. Our fertile farms and our teeming seas, lakes and streams, are our sources of food. Our mines give us a steady flow of useful and precious minerals. Lumber and pulp are supplied by our vast tracts of forest land. Waterpower sites assure us of a liberal supply of energy.

**Differences in the Productivity of Land.** Broadly, no two farms are equally productive. The same may be said of oil wells, mines, forests and fisheries and of all land. Some land is exceedingly fertile; the sand-blown arid wastes of the desert are proverbially sterile. Between the two extremes, highly productive land and completely non-productive land, there are many degrees of land productivity. The more productive the land, the smaller will be the effort required to produce a given crop. Land in the Okanagan and Annapolis Valley, and in the fruit belt bordering Lake Erie, is more productive than the fodder-crop farms of the Canadian Shield. It is well to remember that an acre of land producing forty bushels of wheat is the equivalent of four acres with an average yield of ten bushels.

**Location of Land.** Location does not affect the productivity of land, but it affects the farmer's price for produce, the miner's price for ore and the fisherman's price for fish. Distance from

the market and the degree of accessibility by cheap means of transportation affect the spread between prices paid to primary producers and the price of goods in the city produce market. Since there can be only one price in the same market for a given article at a given time, it follows that, as the cost of transporting goods to market increases, the farmer's returns will decrease. This relationship between the location of land and the primary producer's returns determines the limit of settlement away from means of transportation. Settlers will haul grain to the country elevator over a distance of several miles, but they will not break land beyond a certain distance from the elevator. The relationship between location and returns also applies to real estate in cities, towns and villages. A lot in the centre of a city brings higher returns than a lot situated at the outskirts of the city.

**The Supply of Land.** *Farm Land.* The number of square miles of land under cultivation accounts for a relatively small percentage of the total land area of the world. Of 55,500,000 square miles less than 5,000,000 square miles are under cultivation. Canada has a land area of 2,212,790,000 acres. In 1931 we had 57,670,000 acres of farm land under crop. In the same year we had over 300,000,000 acres of potential agricultural land waiting for the ploughshare. The supply of highly productive and easily accessible land must always remain limited, chiefly because of climate, topography and national boundaries. Changes in the fertility of soil, chiefly due to climate, alter the supply of arable land. Many regions which once supported dense populations are now barren.

There are vast tracts of land suitable for cultivation which remain unused. Still, the hinterland is ever receding before the determination of hardy pioneers. Colonization is going on to-day in Canada, Australia, Manchukuo, and at least twenty other countries.

The productivity of land is given a permanent character by irrigation, which has been practised from time immemorial. To-day irrigation culture supports approximately one-third of the human race.

*Fisheries.* Many bodies of fresh water have been depleted of edible fish. Restocking is carried on by means of fish hatcheries at strategic points. The supply of fish from the sea seems inexhaustible, although certain species, once caught in great quantities, are now unimportant on account of their decreased numbers. The long coastline of Canada assures us a prominent rank in world fisheries, which have an estimated annual output of \$1,000,000,000.

*Forestry.* The time required to grow trees is the important factor affecting the supply of raw materials which originate in the forest. If the rate of depletion is higher than the rate of replacement forest supplies dwindle. A more hopeful aspect of the problem is the fact that much of the land area of the world which is unfit for agricultural purposes is suitable for forestation. This partly explains why thirty-one per cent. of the land area of Europe is wooded.

In forestry, as well as in agriculture, productivity of land is important. Certain soils will not grow trees. Here, too, climate is a dominant factor; rainfall is a controlling element in the promotion of rapid growth. Accessibility must also be taken into consideration. The cost of transportation often prevents the use of otherwise valuable "stands."

*Mines.* Mineral deposits are subject to complete depletion. Living things are self-replacing. Inanimate things, such as coal, iron, salt and gold, once removed from the earth's strata, where they were deposited by nature, cannot be replaced. We may salvage scrap-steel and secondary copper, but the amount thus saved would not long supply our requirements.

The remoteness of certain deposits, and our inability to work very far below the earth's surface, limit the available supply. Refinements in the art of prospecting may reveal mineral wealth hitherto unsuspected.

*Water Power.* Production demands sources of energy to supply heat and power. Current is also needed to carry on electrolytic processes. All three are supplied by the energy of waterfalls. Three factors determine the quantity of water-

power obtainable: a sufficiently rapid change in elevation, rainfall, and natural or artificial barriers to check and regulate the flow. The atmosphere does the work by taking water-vapour at points close to sea-level and elevating it to higher altitudes where it is chilled and condensed. It then comes down as rain to flow back to sea-level. In its race towards the ocean it is harnessed by man to perform useful tasks.

Although the supply is limited, and varies with rainfall, it is by no means fully utilized. The United States stands first and Canada second in water power utilization.

**The Law of Diminishing Returns.** In the cultivation of an acre of land, it is found that the yield obtainable is limited. If it were otherwise, it would be possible to supply a whole nation with wheat from a single acre of land. Obviously, if the amount of labour and capital expended on this acre of land is increased, this limit is pushed forward, but it cannot be pushed forward indefinitely. The yield is limited under any circumstances. This fact leads to a problem which must be solved by all primary producers. To what extent will it pay to push this limit forward? The farmer knows that if he hires more help and buys more machinery and fertilizer he will be in a position to increase the output of his farm. He also knows that he must not increase his cost of production overmuch or he will reach a point beyond which additional applications of labour and capital will not yield proportionate returns. Although the total returns from all the dollars invested may be larger, each succeeding unit of investment, after this point is reached, will yield less than the preceding one.

Take, for instance, a plot of land on which wheat is grown with the following results:

Investment	Yield
\$5.....	15
\$6.....	19
\$7.....	22
\$8.....	23
\$9.....	23

When five dollars are invested, each dollar of investment yields three bushels of wheat. The successive increases in investment, however, at first give increasing returns, and then decreasing returns. The turning point at which returns per dollar invested cease to increase and begin to decrease is the point of diminishing returns. We can make this more evident by another tabulation:

- The first \$1 increase in investment yields 4 bush.
- The second \$1 increase in investment yields 3 bush.
- The third \$1 increase in investment yields 1 bush.
- The fourth \$1 increase in investment yields 0 bush.

We are now in a position to state the law of diminishing returns: When production is increased beyond a certain point each additional unit of investment yields smaller returns than the preceding one.

It is not to be supposed that production will not pay beyond this point and that no further increase in investment should be made. Indeed, successful enterprisers invest beyond the point of diminishing returns because the next dollar invested will likely yield returns sufficient to justify its investment, although these returns may be smaller than those obtained just at the point of diminishing returns. Naturally, the decision of the enterpriser will be influenced by the prospective price of the product. He will make sure that the cost of the increase in output will not exceed the returns obtained. If the price of wheat is one dollar per bushel, the farmer who is tilling this particular plot of land will be faced with the following problem of costs and returns:

Increases in Investment	Changes in Terms of Costs	Changes in Terms of Returns
\$5—\$6	Decreasing costs	Increasing returns
\$6—\$7	Increasing costs	Decreasing returns
\$7—\$8	Marginal costs	Zero returns
\$8—\$9	Excessive costs	Loss

**Proportionality.** From Montreal to Lake Superior, ships have to go through thirty locks. The smallest lock in the thirty not only limits the size of ships which may ascend from Montreal

to Lake Superior, but also limits the usefulness of all the other locks. The Welland Ship Canal is able to accommodate larger ocean ships but its usefulness for that purpose is destroyed by the deficient locks. Likewise in production; although we might use a great number of machines in a given enterprise, if the number of workmen is too small the output will be limited by the one deficient factor. If the enterpriser had hired more men the output would have been greater. He failed to get the proper combination between men and machines, and the volume of production is consequently limited by the lack of proportionality. Moreover, the cost of production is high. Idle machines increase costs without increasing output. To increase the net returns the enterpriser must hire more men. With every new man hired production will increase. It is true, costs will increase also, but they will not increase as fast as production. As the right proportion of men and machines is being approached, production will have a tendency to increase faster than costs. When the ideal combination is obtained, the output will not be limited by any deficiency. Costs will be as low as they possibly can be and the output will have increased to the furthest possible limit. Costs are lowest and output is largest when proportionality exists between the various factors of production.

*Proportionality in Farming:* A farmer who wishes to spend fifteen dollars on an acre of land has several optional ways of making the investment. He may hire additional labour and he may buy certified seed, fertilizer and insecticide. How much of each will he purchase? If he uses poor seed and buys high-priced fertilizer, the crop may be poor. Good seed and cheaper fertilizer might be a better combination. Applying a part of the investment towards the purchase of machinery to be used on his farm might increase the output. He might gain by spending less on seed, fertilizer, insecticide and machinery, and more on labour. If he strikes an utterly wrong combination between these various factors the output will be low. A good combination will mean a higher output without increased costs and will also mean higher returns. Proportionality between

labour and capital is essential to successful farming. Without proportionality the farmer cannot obtain the largest possible net returns.

#### EXERCISES AND PROBLEMS

1. Define land.
2. What are the chief uses of land?
3. Show how location and productivity of land affect the farmer's price for produce.
4. What determines the limit of settlement away from means of transportation?
5. What causes a plot of land in a city to yield higher returns than one in the suburbs?
6. Draw a circular graph showing Canada's land area, land under crops and available agricultural lands.
7. What is colonization?
8. Draw a map of Canada and indicate the "pioneer fringe."
9. What is the art of prospecting?
10. Explain the law of diminishing returns.
11. Explain proportionality.
12. If you had \$100 to spend on each of the following, how would you distribute the expenditure?
  - (a) A tennis-court.
  - (b) A lawn.
  - (c) A garden.
13. What principle guided your choice of expenditures on each of the above? Explain.
14. Discuss the problem of conserving soil fertility.
15. Explain how a forest or mine operator can waste natural resources.
16. What is Canada's annual loss from forest fires? (Consult the *Canada Year Book*.)
17. What is reforestation?
18. Write an essay on the conservation of natural resources.
19. Where are courses offered in Canada in each of the following.
  - (a) Scientific Agriculture?
  - (b) Scientific Forestry?
  - (c) Mining Engineering?

## CHAPTER VI

# LABOUR

**Definition.** Labour is work performed by man as a means of acquiring wealth or income. Labour, then, is on a higher plane than mere mechanical work performed by machines and by domestic animals. Moreover, it should not be considered as a commodity which can be bought at a given price to be incorporated into goods and sold at a profit. Labour differs from play with the exception of those sport and theatrical activities which involve a money consideration. Hunting and fishing are labour unless they are engaged in solely for recreational purposes.

**Kinds of Labour.** Labour may be divided into labour of brain and labour of hand. This distinction is not sharply defined. Labour of brain demands physical effort, be it only talking or writing, and manual labour is always accompanied by a certain amount of thinking. The simplest operations in industry, such as pressing on a pedal or pushing a lever, must be properly timed and therefore require mental exertion.

Labour of brain without labour of hand would not go very far in producing goods to satisfy our wants. Manual labour, on the other hand, would be comparatively unproductive without brains to organize production. During the past hundred years the output per worker has increased by leaps and bounds, a result of the work of creative minds who have invented new machines, discovered new processes and developed scientific management.

**The Productivity of Labour.** The quantity of goods produced and the number of services rendered vary from worker to worker. Skill, strength and speed determine the output. These are improved by technical training, healthful habits, sanitary surroundings, reduced hours of labour, security and

contentment. In estimating the labour force of the country we must always keep in mind that there are good workers and idlers. An army of inefficient workers might be less productive than a small number of alert and industrious men. Labour productivity is greatly enhanced by the use of tools and machines, and of scientific methods of production which save useless movements and co-ordinate the activities of the labour force.

**The Division of Labour or Specialization.** The work of producing goods to satisfy human wants is divided among the members of society. Although many workers are employed at the same kind of work, each person is a specialist in his own line. Each worker is employed at the production of a small number of articles in large quantities while he consumes a large number of articles in small quantities. The factory operative performs the same operation hundreds of times in a day, and does nothing else. His activities are usually restricted to co-operating in the production of a single article. The great variety of goods he and his dependents consume are produced in the same way by other workers. This gives rise to the problem of exchanging goods, a problem which we shall study later.

There are four kinds of specialization: by places, by occupations, by tasks and by stages.

1. Geographical specialization, or specialization by places, is a result of the combination of certain advantages in certain places.

Climate, accessibility to market and to raw materials, and the presence of a certain type of skill in the population, combine to localize the various industries in definite places. Thus, southwestern Ontario grows corn and tobacco, Copper Cliff is noted for its nickel industry, Windsor manufactures automobiles, the Prairie Provinces specialize in cereals; Brazil is famous for her coffee, Australia for her wool, and Canada dominates the world market for wheat.

2. Specialization by occupations is evidenced by the great

number of trades. There are butchers, grocers, photographers, printers and followers of many other special vocations.

3. Specialization by tasks is more complex than the simple division of labour by occupations. This breaking up of work in different portions is well exemplified by the automobile industry where, as far as practical, only one operation is performed by each worker.

4. Specialization by stages takes place in many industries where the product of one manufacturer is passed on to another who turns it into a finished product. As an example, the farmer produces wheat which he sells to the miller, the miller turns the wheat into flour which he sells to the baker. The baker changes the flour into bread, the finished product.

*Advantages of the Division of Labour.* (1) The main advantage of specialization is that it allows the concentration of a great number of workers who engage in the production of a given article. Specialization is important because it makes possible co-operation on a large scale. The product of ten men working together is greater than ten times the product of one man. Two hundred men working together a single day raised the obelisk on the Place de la Concorde in Paris. One workman working two hundred days would very likely have accomplished nothing. (2) Specialization enables the worker to develop skill and speed in the one operation he has to perform. (3) Specialization by tasks makes possible the use of conveyors which set the pace for the men at work and save unnecessary movements. (4) Specialization by tasks reduces the cost of training labour forces. (5) Once the job is divided into simple operations complete mechanization often becomes possible. (6) Regions which are best fitted for the production of a given commodity can restrict their activities to a single line of goods and thereby increase the total output.

*Disadvantages of the Division of Labour.* It has been argued that specialization destroys the wide general skill of the craftsman, makes work monotonous and renders certain regions too dependent on a continuous market for a single commodity.

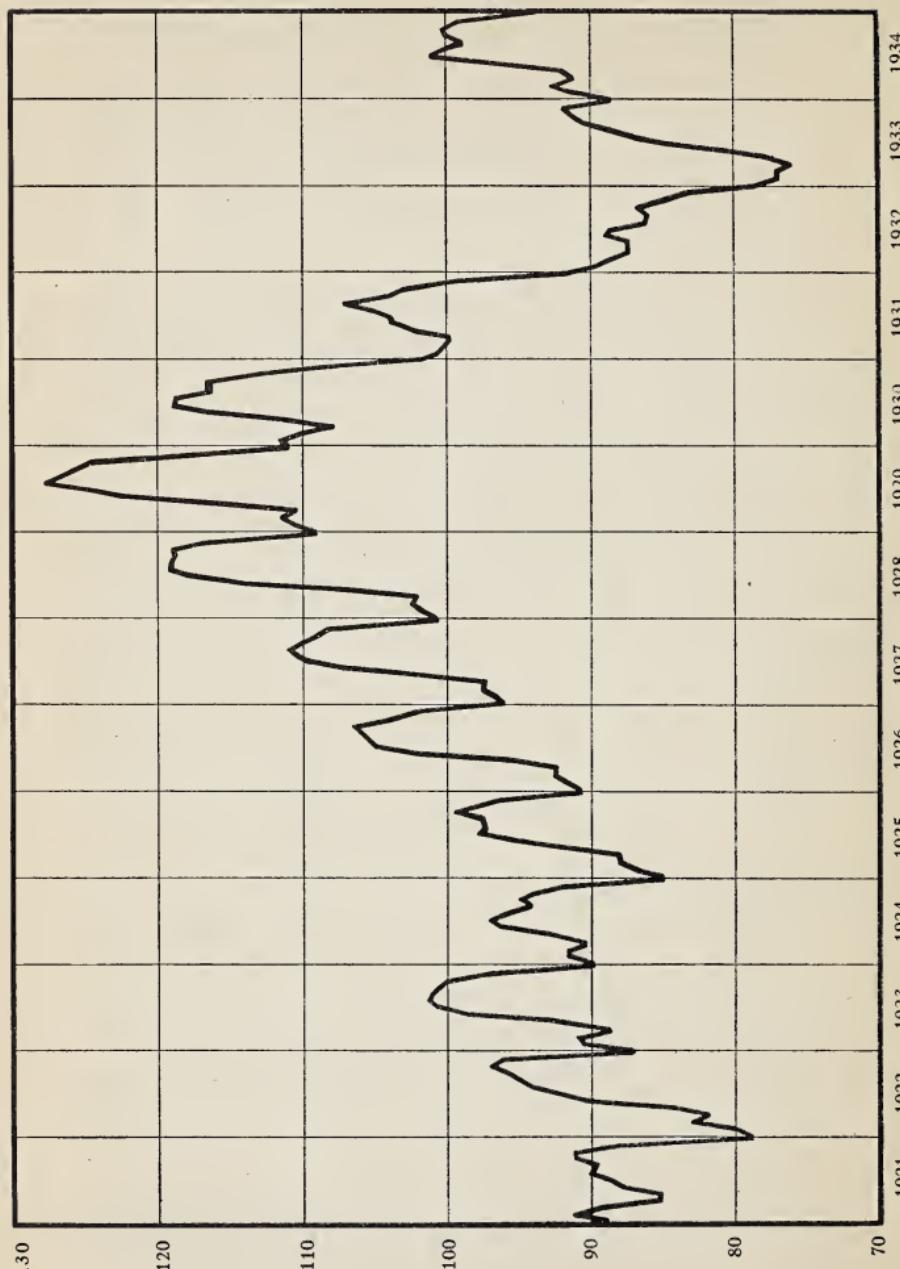


FIG. 11. EMPLOYMENT

Cuba is a typical example of a country which has over-specialized, viz., in the production of cane sugar. The great disadvantage of specialization is that it creates the necessity of exchange; the more extensive is specialization the more difficult becomes the solution of this momentous problem.

**Unemployment.** The problem of unemployment is chiefly the problem of business depressions. The main kind of unemployment is due to the recurrence of the depression phase of the business cycle. Even in times of prosperity and industrial activity, however, we have unemployed people who do not fit into the pattern of production. They are in enforced idleness. Some of this idleness is seasonal. The forest, agricultural and fishing industries hire men only for certain months in the year. The automobile industry is notoriously unstable in that respect and so are numerous other industries which depend on a demand which is highly seasonal. There are industries, as well, such as the food-packing industry, which operate at capacity only when their seasonal raw materials come to maturity. A casual glance at the curve of employment in Canada reveals these seasonal changes in a realistic manner.

The rapid introduction of technological improvements, such as new inventions and new methods of production, causes unemployment. Workers displaced by more efficient methods of production cannot readily adjust themselves to the new situation. Men who have learned crafts by serving a long period of apprenticeship are not easily transferred from one kind of work to another. The printing industry affords a noteworthy example of this kind of unemployment. This is called technological unemployment.

#### PROBLEMS OF POPULATION

**The Increase in Population.** The population of the world is never at a standstill. It may have decreased at certain times in the past but at present it is rapidly increasing. A glance at the accompanying tables will show how population has changed in modern times. The increase in world population is equal to

TABLE 4  
ESTIMATE OF WORLD'S POPULATION

Year	Authority	Estimate Millions	Year	Authority	Estimate Millions
1685	Riccioli.....	500	1886	Levasseur.....	1,483
1704	Nic. Struck.....	500	1891	Ravenstein.....	1,467
1800	Malte-Brun.....	640	1896	Statesman's Yearbook.....	1,493
1810	Almanach de Gotha.....	682	1903	Jaraschek.....	1,512
1816	A. Balbi.....	704	1906	Jaraschek.....	1,538
1822	Reichard.....	732	1910	Annaire Statistique.....	
1828	I. Bergius.....	847		Jaraschek.....	1,610
1833	Stein.....	872	1913	Knibbs.....	1,632
1845	Michelot.....	1,009	1914	Knibbs.....	1,649
1854	V. Reden.....	1,135	1924	World Almanac.....	1,748
1868	Kolb.....	1,270	1924	International Yearbook of Agricultural Statistics.....	1,853
1870	E. Behm.....	1,359	1929	Department of Commerce.....	
1874	Behm and Wagner.....	1,391		United States.....	1,992
1878	Levasseur.....	1,439	1932	League of Nations.....	2,042
1883	Behm and Wagner.....	1,433			

Source: The Secondary School Curriculum, Department of Education, State of Minnesota.

TABLE 5  
POPULATION OF CANADA BY PROVINCES, 1867-1934  
(000's omitted)

Year	Canada	P.E. Island	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.	Yukon	N.W. T.
1867....	No. 3,463	No. 88	No. 364	No. 271	No. 1,123	No. 1,525	No. 15	No. —	No. —	No. 32	No. —	No. 45
1871....	3,689	94	388	286	1,191	1,621	25	—	—	36	—	48
1881....	4,325	109	441	321	1,360	1,927	62	—	—	49	—	56
1891....	4,833	109	450	321	1,489	2,114	153	—	—	98	—	99
1901....	5,371	103	460	331	1,649	2,183	255	91	73	179	27	20
1902....	5,494	101	459	331	1,670	2,194	275	125	96	199	25	19
1903....	5,651	100	460	331	1,709	2,217	296	159	119	220	23	17
1904....	5,827	99	463	333	1,752	2,246	318	194	142	242	22	16
1905....	6,002	99	464	333	1,771	2,289	344	236	166	264	21	15
1906....	6,097	96	465	334	1,784	2,299	366	258	185	279	18	13
1907....	6,411	96	475	341	1,853	2,365	395	311	236	309	18	12
1908....	6,625	95	480	345	1,902	2,412	413	356	266	330	15	11
1909....	6,800	94	483	346	1,931	2,444	427	401	301	350	13	10
1910....	6,988	94	486	348	1,965	2,482	441	446	336	370	11	9
1911....	7,207	94	492	352	2,006	2,527	461	492	374	393	9	7
1912....	7,389	94	496	356	2,042	2,572	481	525	400	407	9	7
1913....	7,632	94	504	363	2,096	2,639	505	563	429	424	8	7
1914....	7,879	95	512	371	2,148	2,705	530	601	459	442	8	8
1915....	7,981	94	511	371	2,162	2,724	545	628	480	450	8	8
1916....	8,001	92	505	368	2,154	2,713	554	648	496	456	7	8
1917....	8,060	90	503	368	2,169	2,724	558	662	508	464	6	8
1918....	8,148	89	502	369	2,191	2,744	565	678	522	474	6	8
1919....	8,311	89	507	373	2,234	2,789	577	700	541	488	5	8
1920....	8,556	89	516	381	2,299	2,863	594	729	565	507	5	8
1921....	8,788	89	524	388	2,361	2,934	610	757	588	525	4	8
1922....	8,919	89	522	389	2,409	2,980	616	769	592	541	4	8
1923....	9,010	87	518	389	2,446	3,013	619	778	593	555	4	8
1924....	9,143	86	516	391	2,495	3,059	625	791	597	571	4	8
1925....	9,294	86	515	393	2,549	3,111	632	806	602	588	4	8
1926....	9,451	87	515	396	2,603	3,164	639	821	608	606	4	8
1927....	9,636	87	515	398	2,657	3,219	651	841	633	623	4	8
1928....	9,835	88	515	401	2,715	3,278	664	862	658	641	4	9
1929....	10,029	88	515	404	2,772	3,334	677	883	684	659	4	9
1930....	10,208	88	514	406	2,825	3,386	689	903	708	676	4	9
1931....	10,376	88	513	408	2,874	3,432	700	922	732	694	4	9
1932....	10,506	88	513	409	2,904	3,459	705	971	740	704	4	9
1933....	10,681	89	522	420	2,970	3,524	722	951	757	712	4	10
1934....	10,835	89	526	426	3,022	3,566	731	966	770	725	4	10

the difference between births and deaths. The birth rate and the death rate vary considerably from country to country and from place to place within the same country.

The immigration and emigration of any country also must be considered. The difference between the two, net immigration or net emigration, must be added to the increase or decrease resulting from natural causes.

Canada has been blessed with a fairly large natural increase in population, but emigration has taken a heavy toll among the native born. An attempt has been made to repair the loss by subsidizing immigration.

**Density of Population.** By density of population we mean the number of people per unit of area, that is, per square mile or per square kilometre. The density of population varies sharply between different parts of the world. Thus the British colony of Hong Kong has a density of over two thousand to the square mile, whereas the density for Canada is three to the square mile.

A dense population often means a low standard of living unless the natural resources of the country and the industry of its inhabitants are such that the production of goods may be stepped up to meet requirements. Sparseness of population also may be responsible for a low standard of living. When a small population is scattered over a wide area much effort is lost in attempting overmuch, through lack of co-operation. Canada has a fairly dense population, if we compute the density on the basis of inhabited regions only. Available statistics of density of population are not comparable because they are based on total land areas, inhabited and uninhabited.

**Rural and Urban Population.** The rural areas are losing part of their population to the cities. Many people leave the farm for the city but the area under cultivation is not decreased. The obvious reason is that with modern farm equipment the labour required to cultivate an acre of land is decreasing year after year.

Labour should seek employment where it is to be found if we are going to make full use of the nation's labour force, not

only to preserve our standard of living, but to improve it. An increase in rural population should not take place if the consequence is that the output per worker is reduced. The increase in rural population brought about by the opening of new land is a wholesome increase, for it is bound to enlarge the total output of the country and lay the foundations for the building of new cities which can thrive only in the midst of a bountiful agricultural wealth.

**Immigration.** According to the 1931 census 2,307,525 residents of Canada were born in other countries. Some of these immigrants were attracted to Canada by prospects of a better living standard; others felt compelled by economic conditions to leave their native lands. Whatever motive may have impelled them to come to our shores, they were welcomed with open arms until unemployment conditions caused native born and immigrant alike to ask for restrictions. At present our gates are practically closed to immigration.

On August 14, 1930, an Order-in-Council was passed limiting immigration, for all except Britishers and citizens of the United States of America, to two classes: (1) wives and unmarried children under eighteen years of age, joining family heads established in Canada and in a position to look after their dependents; (2) agriculturists with sufficient money to begin farming in Canada. In addition, all Canadian Government Information Bureaus in the United States were closed and the number of agents in the British Isles was reduced. As a further measure the provision of the Immigration Regulations whereby immigrants must have sufficient funds to support themselves until employment is found was made more restrictive by increasing the amount of the minimum sum required.

A study of the tables of Immigrant Population and of the Origins of the People will reveal the nature of our immigration in the past. The graph of Immigration and Emigration shows more recent developments.

**Emigration.** While Canada was attracting thousands of immigrants, native born Canadians were leaving in large num-

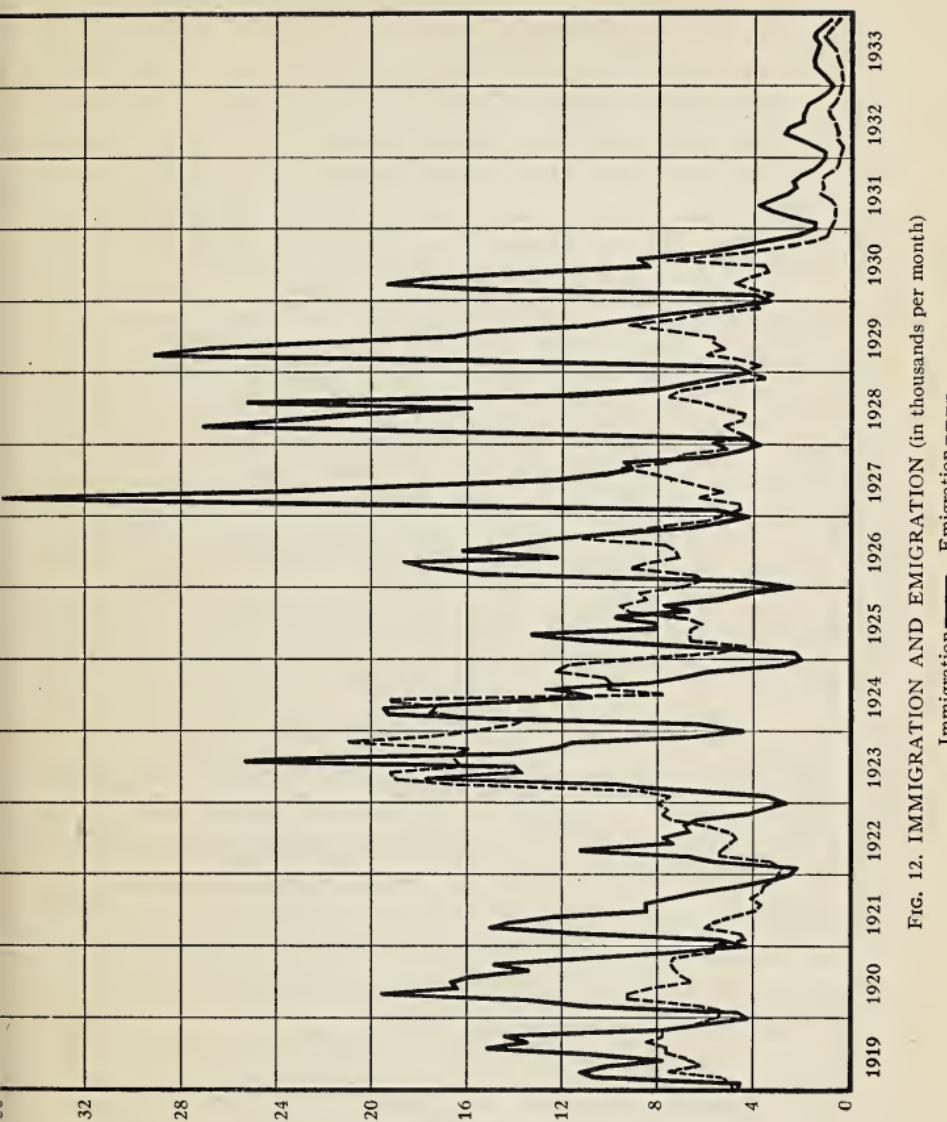


FIG. 12. IMMIGRATION AND EMIGRATION (in thousands per month)  
Immigration — Emigration - - -

TABLE 6

## IMMIGRANT POPULATION BY COUNTRY OF BIRTH, 1931

England.....	723,864	31.37	Hungary.....	28,523	1.24
U.S.A.....	344,574	14.93	Newfoundland.....	26,410	1.14
Scotland.....	279,765	12.12	Czechoslovakia.....	22,835	0.99
Poland.....	167,985	7.29	Wales.....	22,348	0.97
Russia.....	114,406	4.96	Denmark.....	17,217	0.75
Ireland.....	107,544	4.66	Jugoslavia.....	17,110	0.74
Italy.....	42,578	1.84	Belgium.....	17,033	0.74
China.....	42,037	1.82	France.....	16,756	0.73
Roumania.....	40,322	1.75	Ukraine.....	13,759	0.60
Germany.....	39,163	1.69	Japan.....	12,261	0.53
Austria.....	37,391	1.61	Holland.....	10,736	0.47
Sweden.....	34,415	1.49	Others.....	65,460	2.84
Norway.....	32,679	1.41	Total.....	2,307,525	100.00
Finland.....	30,354	1.32			

TABLE 7

## ORIGINS OF THE PEOPLE ACCORDING TO THE CENSUS OF 1931

French.....	2,927,990	28.22	Chinese.....	46,519	0.45
English.....	2,741,419	26.42	Finnish.....	43,885	0.42
Scottish.....	1,346,350	12.97	Hungarian.....	40,582	0.39
Irish.....	1,230,808	11.86	Danish.....	34,118	0.33
German.....	473,544	4.56	Bulgarian and Roumanian.....	32,216	0.31
Ukrainian.....	225,113	2.17	Czechoslovakian.....	30,401	0.29
Hebrew.....	156,726	1.51	Belgian.....	27,585	0.27
Dutch.....	148,962	1.44	Japanese.....	23,342	0.22
Polish.....	145,503	1.40	Negro.....	19,456	0.19
Indian and Eskimo.....	128,890	1.24	Icelandic.....	19,382	0.19
Italian.....	98,173	0.95	Yugoslavic.....	16,174	0.16
Norwegian.....	93,243	0.90	Greek.....	9,444	0.09
Russian.....	88,148	0.85	Other.....	98,868	0.95
Swedish.....	81,306	0.78	Total.....	10,376,786	100.00
Austrian.....	48,639	0.47			

bers to establish residence in the United States of America. At the same time many hundreds of immigrants used Canada as a stopping place. This latter class usually settled at border points and took advantage of the first opportunity to cross the boundary. The importance of the movement to the United States which has taken place among the native born population cannot be overestimated. In 1930, according to the United States census, there were residing in the United States 1,278,421 persons who were Canadian-born.

## EXERCISES AND PROBLEMS

1. What is labour?
2. How does labour differ from play?
3. Is labour of hand more productive than labour of brain? Explain.
4. How can the productivity of labour be improved?
5. Explain division of labour.
6. What is geographical specialization?

7. What is occupational specialization?
8. Give four examples of specialization by stages.
9. What are the advantages of the division of labour?
10. Show how the division of labour creates the problem of exchange.
11. Draw a graph showing the changes in population in your city, town or village since its foundation.
12. Explain density of population.
13. Why are available statistics of density of population not comparable?
14. What is the ratio between population and area of land under crop in Canada?
15. What percentage of the population of Canada was born abroad, according to the 1931 census?
16. Why is Canada restricting immigration?
17. What steps have been taken to restrict immigration since 1931?
18. How do you account for the large number of native born Canadians residing in the United States?
19. Is wholesale emigration to the United States a result of unrestricted immigration?
20. What tests would you apply to a prospective immigrant?

## CHAPTER VII

### CAPITAL

**Definition.** Man can facilitate his task of extracting a living from nature by providing himself with tools, machinery and equipment of various sorts. Anything produced by man for the purpose of producing more goods is called capital. Capital, as well as land, is a form of wealth used in production. While land is a free gift of nature, capital is the result of past production. The difficulty often encountered in distinguishing between land and capital can be solved by studying the origin of the thing to be classified. A ditch on a farm, excavations in a mine are capital; they exist only through man's exertion.

Capital, in the economic sense, must not be confused with dollars. In bookkeeping practice it is customary to call capital the amount of money invested in an enterprise. A person's net worth—that is, the difference between his assets and his liabilities, between what he owns and what he owes—is called his capital. These several meanings of the word *capital* must be kept distinct.

**Kinds of Capital.** Capital is generally classified as producers' goods and consumers' goods. Consumers' goods are those which have been produced for the satisfaction of human wants; they include durable goods, such as houses, monuments, pictures, etc., which are consumed over a relatively long period of time, and perishable goods, such as milk, butter, bread and wheat, which are generally consumed shortly after production. Capital is again sub-classified as fixed capital and circulating capital. Fixed capital is that which is durable; houses, machinery, buildings, railroads, city improvements, are examples. Fixed capital is represented in the financial world by long-term investments in the form of stocks, bonds, mortgages and debentures. Circulating capital, which consists of goods in stock and in process of receiving utility, is represented in

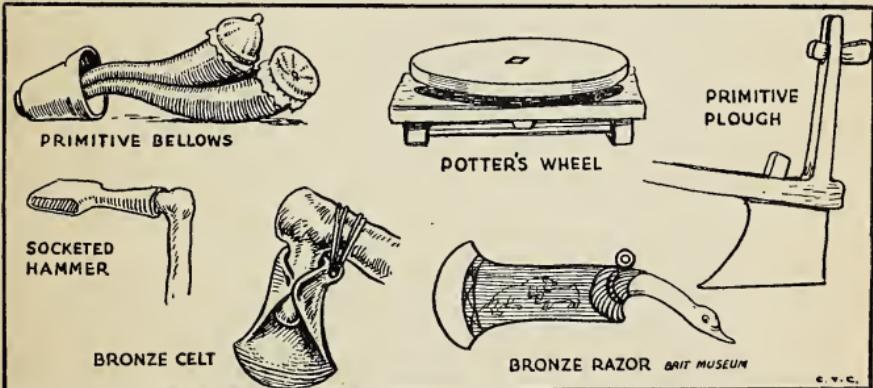
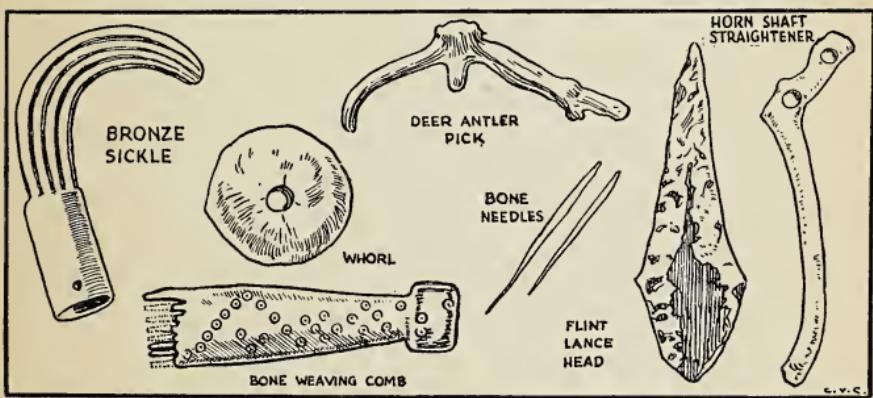
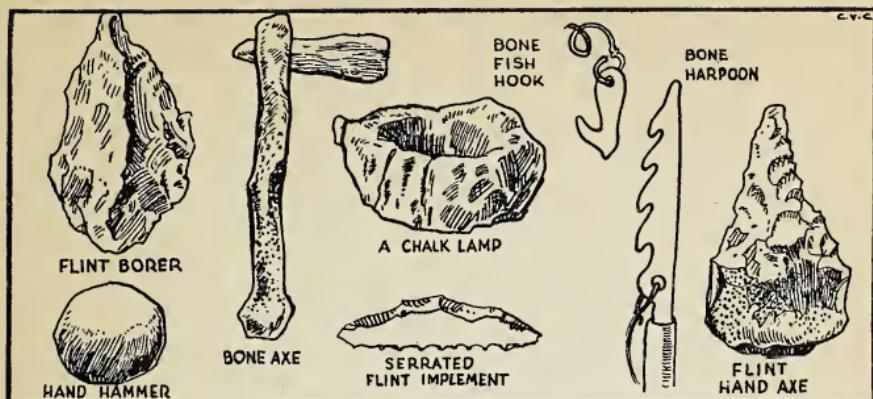


FIG. 13. PRIMITIVE CAPITAL

finance by short-term investments in the form of commercial loans usually made by banks over periods of thirty, sixty, or ninety days.

**Origin of Capital.** A new colony has only that capital which the original settlers bring from the mother country. To this are added capital produced in the new land and new imports of capital.

Capital is produced in the new land only if conditions permit the use of a part of the labour force to that end. This becomes possible as soon as the inhabitants limit consumption or increase production to the point where they can support a native producers' goods industry. Moreover, exports from the new land, usually in the form of raw material or foodstuffs, pay for imports of new capital from older countries.

In old countries new capital is produced whenever there is demand for it by enterprisers. Great quantities of machinery are produced each year to replace what has been worn by the wear and tear of industry. Some equipment becomes obsolete and must be replaced by new equipment. New enterprisers are constantly demanding new capital. Wherever there are prospects of gain, new capital is bought and set in motion to capture the anticipated profit.

The funds used to buy new capital come, in part, from the savings of the nation, most of which savings represent the unspent income of corporations and of wealthy individuals. The remainder of the funds used to buy capital goods is created by the banks which make advances, in the form of collateral loans, to enterprisers. It must be understood that at certain times some savings are not invested; they remain unused. At other times investments exceed savings; this is made possible by the creation of credit through the banking system.

**The Capitalistic Method of Production is a Roundabout Method.** If an enterpriser decides to produce shoes he must first obtain land for a factory. He then finds a contractor to build a plant. The next step is to install machinery. Once this has been accomplished a labour force is hired and trained.

Designs are made. Raw materials are purchased and production begins. A full year may elapse before the production of shoes actually starts. This is in striking contrast with the method followed by the savage. A knife is used to cut leather from the hide of a wild animal and bone needles ply deftly between the fingers of a squaw. A few hours after the order is given, the master's shoes are ready to wear.

In the large plant, once the machinery is set in motion, thousands of pairs of shoes are produced, and each worker, by co-operating with his fellow workers, produces the equivalent of a pair of shoes in an incredibly short time. The saving of time and energy is tremendous and hundreds of men are released for the production of other articles needed to maintain or to improve our standard of living.

**The National Wealth of Canada.** In computing the wealth of a country, land as well as capital must be considered. The value of the national wealth is found in terms of the money unit. Since the money unit is always changing in value, estimates of national wealth are not comparable from year to year unless adjustments are made to account for the changing value of the dollar. The table of estimated national wealth reveals striking facts. More than forty per cent. of the national wealth consists of real estate. Contrary to general opinion, and to statements often expressed in business circles, only slightly more than five per cent. of our wealth consists of machinery. For every dollar of capital funds invested in machinery there are nearly twenty dollars invested in other forms of wealth. According to agricultural statistics compiled at the last census, implements and machinery accounted for only 12.4 per cent. of total farm values exclusive of municipal improvements and rural public utilities.

Value of national wealth roughly represents the capitalization of income from wealth. If the general rate of interest is five per cent., an acre of land yielding an income of five dollars will be capitalized at one hundred dollars. At the same rate of interest a building which gives an income of \$1,000 per year will be worth \$20,000.

TABLE 8

ESTIMATE OF THE NATIONAL WEALTH OF CANADA,  
AS IN 1929

Classification of Wealth	Aggregate Amount	Percentage of Total	Average Amount per head of Population
	\$	p.c.	\$
Farm Values (land, buildings, implements, machinery and livestock).....	6,308,353,000	20.45	629.01
Agricultural Products in the possession of farmers and traders.....	1,631,124,000	5.29	162.64
Totals, Agricultural Wealth.....	7,939,477,000	25.74	791.65
Mines (capital employed).....	867,021,000	2.81	86.45
Forests (estimated value of accessible raw materials, pulpwood and capital invested in woods operations).....	1,877,000,000	6.09	187.16
Fisheries (capital invested in boats, gear, etc., in primary operations).....	33,935,000	0.11	3.38
Central Electric Stations (capital invested in equipment, materials, etc.).....	554,327,000	1.80	55.27
Manufactures (machinery and tools, and estimate for capital in rural lands and buildings)*.....	1,418,040,000	4.60	141.39
Manufactures (materials on hand and stocks in process)*.....	837,805,000	2.72	83.54
Construction, Custom and Repair (estimated investment in machinery and tools and materials on hand).....	137,685,000	0.45	13.73
Trading Establishments (estimated value of furniture, fixtures, delivery equipment and materials on hand).....	1,136,291,000	3.68	113.31
Steam Railways (investment in road and equipment).....	3,153,351,000	10.22	314.42
Electric Railways (investment in road and equipment).....	240,111,000	0.78	23.94
Telephones (cost of property and equipment).....	291,589,000	0.95	29.07
Urban Real Property (assessed valuations and exempted property and estimate for under valuation by assessors and for roads, sewers, etc.).....	8,251,011,000	26.75	822.73
Canals (amount expended on construction to March 31, 1930).....	241,946,000	0.79	24.12
Harbours (approximate amount expended to March 31, 1930).....	367,488,000	1.19	36.64
Shipping (including aircraft).....	149,306,000	0.48	14.89
Imported Merchandise in store (estimated at one-half imports during 1929).....	649,477,000	2.11	64.76
Automobiles (estimate of the value of automobiles registered).....	758,424,000	2.46	75.62
Highways, etc.....	364,896,000	1.18	36.38
Household Furnishings, Clothing, etc. (value estimated from production and trade statistics).....	1,370,000,000	4.44	136.61
Specie, Coin and other Currency held by the Government, chartered banks and the general public.....	201,030,000	0.65	20.04
Totals.....	30,840,210,000	100.00	3,075.10

\*Duplication excluded.

**Outside Capital Invested in Canada.** Ownership of Canadian wealth is not limited to Canadians. Capital funds have been invested in Canada by outsiders to a considerable extent. There are many reasons for these investments. Our expanding industries required more funds than could be obtained in Canada. Scarcity of funds for long-term investment is nearly always characteristic of new countries. Moreover, our financial system has always been managed on a conservative basis. Willingness to bear the risks of enterprise has often been lacking. Safety has always been the main consideration of our banking system.

The erection of branch plants by foreign corporations has been a notable factor in recent years. The producers of trademarked goods enjoying a sufficiently wide market in Canada have made a practice of opening branch plants in this country whenever their products have been shut out by high tariffs. The international good will enjoyed by made-in-Canada merchandise has also been an inducement for foreign manufacturers to manufacture in Canada goods for export.

In times of war, capital is borrowed abroad to supplement home savings. War financing, to provide funds for government expenditure and to develop our industries for war needs, was perhaps the main factor responsible for the large investments made here by foreigners.

Outside investments in Canada are counterbalanced in part by investments made by Canadians in other countries. At times Canadian investors have bought heavily in the New York market and the foreign operations of our insurance companies have added materially to Canadian investments abroad.

#### EXERCISES AND PROBLEMS

1. Define capital.
2. Give several meanings of the word capital.
3. Give examples of fixed capital and of circulating capital.
4. Give examples of long-term investments and of short-term investments.
5. Increases of capital are equal to the surplus of production over immediate consumption plus net imports or minus net exports. Explain.
6. Describe the development of capital in New France.
7. Describe the development of capital in old countries.
8. How can investments exceed savings?

9. Why is the capitalistic method of production called "roundabout?"
10. What are the results of roundabout production?
11. Does machinery occupy a very important place in an inventory of our national wealth?
12. Arrange the items in the table of national wealth in their order of importance.
13. Explain "capitalization of income."
14. What percentage of our national wealth is owned elsewhere than in Canada?
15. What factors have been responsible for the ownership of a large part of our national wealth by non-Canadians?
16. Are the following capital or land:  
(a) A mine shaft? (b) A drainage canal? (c) A reclaimed swamp?
17. Make separate lists of industries producing:  
(a) Producers' goods.  
(b) Durable consumers' goods.  
(c) Perishable consumers' goods.
18. How does anticipation of profits affect the producers' goods industry?
19. Obtain from the financial page of your newspaper ten examples each of stocks and bonds.
20. An automobile manufacturing corporation wishes to finance the purchase of raw material and parts for 10,000 cars. A bank advances the money required. Is the bank making a long term or a short term investment? Will the bank receive stocks, bonds or promissory notes?

## CHAPTER VIII EXCHANGE

**How We Exchange.** Under the present exchange system, the owners of land and capital and those who perform the work of production receive from the economic enterprise a share of the selling proceeds of the goods or services sold. The stockholder receives dividends, the individual enterpriser and the partner take profits, the landowner receives rent, and the hired individual is paid wages. Moreover, the money-lender is paid interest, the inventor and the writer are given royalties, and the government collects taxes. All these the consumer receives in the form of money which may be defined, for the purpose of studying exchange, as rights to receive goods and services. To simplify the problem, cash disbursements may be called outgo, and cash receipts, income. What is outgo for the producer is income to the consumer.

Obviously, the producer's outgo is also his cost of production. For every dollar he pays out, he places a dollar's worth of goods on the market. When the consumers exercise their rights to receive goods, that is, when they spend their money, the producer gets it back in the form of income. So, what is outgo for the consumer becomes the producer's income. In the economic system there is always a flow of dollars, or rights to goods and services, from the producer to the consumer and back to the producer; and there is a flow of goods from the producer to the consumer who holds rights to the goods produced.

**Value.** When we exchange goods for goods, or services for services, or goods for services, we naturally wish to know how much we will get for what we are giving away. Since practically all exchanges are made in terms of money, we wish to know how much money we shall receive as income for our goods and services and how much money we shall have to expend as outgo

for the goods and services we buy. The amount of money we pay or receive for anything we buy or sell is the price of what is exchanged. However, we are not satisfied with the bare knowledge of how much we have to pay. We desire to know also why we are paying a certain price. To understand why we pay a certain price for an article we must bring in the idea of value. The word value is ambiguous. It has two meanings which Adam Smith distinguished by using the phrases "value in use" and "value in exchange."

**Value in Use.** A schoolboy and a middle-aged business man comparing the value to themselves of a fountain pen and a pair of skates would not reach the same conclusion. They would place different estimates on the importance of the same commodity or service. Subjective value or value in use is the individual's own rating of the capacity of a commodity or service to satisfy his wants. Value in use is, therefore, the same as the utility of the commodity, or service, as appraised by the individual.

**Value in Exchange.** At any given time a dollar bill has a certain purchasing power which is determined by prices then in force; that is, one dollar will buy just so much, according as prices are high or low. If prices are low, a dollar will command more goods in exchange for itself than if prices are high. This purchasing power or capacity of the dollar to command goods and services in exchange is called the value of the dollar. If the dollar has a certain value, or purchasing power, anything which is priced one dollar has the same purchasing power as the dollar. An article worth three dollars, say, a yard of silk cloth, has three times the value of the dollar. And if other prices change, while that of silk cloth remains the same, the value of silk cloth is changed; that is, if other prices fall, the power of a yard of silk cloth to command other goods in exchange increases, and if other prices rise, the exchange power of the silk cloth decreases. Things which change together are said to be related. The relationship between things which are exchanged, or which may

be exchanged, as between a yard of silk cloth and all other exchangeable goods, we call value in exchange.

**The Marginal Utility Theory of Value.** As previously stated, in the consumption of a series of identical goods each succeeding unit provides less satisfaction than the preceding one. This is the law of diminishing utility. Taking up again the example used to illustrate this law, let us ask the question: At what unit will consumption stop? The answer is: Evidently at that unit which will procure the least amount of satisfaction. The final chocolate will have just enough utility to be desired and consumed. This is the marginal utility chocolate or the marginal consumption chocolate. It is called the marginal utility unit because it has just sufficient utility to be desired and it is the marginal consumption unit because it is the last unit that will be consumed in those given circumstances.

Most goods are limited in quantity. In most cases consumption must stop before the marginal utility unit is reached. The last unit consumed usually has much more than marginal utility. The reason why the marginal consumption unit does not coincide with the marginal utility unit is that goods capable of satisfying human wants are limited in number. Scarcity, then, determines the marginal unit of consumption. On the other hand, the consumer's purchasing power also is limited. His wants compete among themselves to get the largest possible share of his purchasing power. Scarcity and competition among the consumer's wants for his purchasing power have a tendency to widen the spread between the marginal consumption unit and the marginal utility unit.

This spread caused by the extent and intensity of our wants on the one hand, and by scarcity on the other, is the measure of the value of any given article. Economic goods have value and command a price because there are not enough of them to satisfy our marginal wants. Free goods are free because they are available in quantities sufficient to satisfy our marginal wants.

The consumer, balancing his wants and his purchasing power, sets the value of goods. Prices are high because consumers are

willing to pay high prices and not because producers charge high prices. Pearl-divers ply their perilous trade because pearls bring a high price; pearls do not bring a high price because diving is dangerous. In the same way, the cost of production of goods, and profits, are high because consumers pay a high price for the finished product.

**Price.** The amount of money for which a good can be exchanged is the price of the good. Price is the money value of the article exchanged. In other words, it is the amount in dollars and cents for which a good is bought and sold. Price must not be confused with value. The value of an article is always changing, even when its price remains the same. Gold was priced at \$20.67 an ounce for a great many years. At every instant in that long period of time the value of gold changed because the value of gold depended just as much on the prices of all other articles as on the price of gold itself. A package of chewing gum seldom retails for more or less than five cents. When other prices are high the value of a package of chewing gum is not so great as when other prices are low. It is evident that if the value of an article changes when its price remains the same, price and value must be different things. What leads to confusion in distinguishing between price and value is the circumstance that at any given time price is representative of value, although when we compare one time with another a change in value is not necessarily followed by a change in price and a change in price is not absolute evidence of change in value.

**Supply and Demand.** Supply is the amount of a good that will be sold at a given price. Demand is the amount of a good that will be bought at a given price. Supply, demand and price are closely related. A change in one of the three brings about changes in the other two.

1. Changes in supply.
  - (a) When supply is increased, price falls.
  - (b) When supply is decreased, price rises.

2. Changes in demand.
  - (a) When demand increases, price rises.
  - (b) When demand decreases, price falls.
3. Changes in price.
  - (a) When price rises, supply increases and demand decreases.
  - (b) When price falls, supply decreases and demand increases.

It is not assumed that a change in one of the factors will bring about a corresponding change in the other two. If the demand for an article doubles, it does not follow that the price will double. The demand for Dominion of Canada bonds may increase threefold on a given day, but the price will likely rise only a point or two.

The relationships outlined above are usually called the law of supply and demand. This law is often resorted to as a sort of magic formula to explain anything which occurs in the business world. More often than not the person who loosely resorts to such explanations has failed to grasp the most elementary principles of economics.

**Market Price.** Price in the market is the result of competition between buyers and sellers. Buyers evaluate the price they ought to pay. Sellers estimate the price at which they ought to sell. Buyers will form their estimate on the basis of getting the greatest possible want satisfaction for their money. Sellers will attempt to cover their production costs, but they will do so only if consumers are willing to buy their products at their prices. If any scarcity is felt, buyers will bid up prices. If the market is oversupplied with a certain product, buyers will bargain down the price.

**Customary Prices.** We have stated previously that customs are more or less permanent habits which extend to all the members of a group forming a community. One of these habits, which is important in the study of exchange, is that of continuing to pay a certain price just because it is a long-established price. Chewing-gum, chocolate bars, street-car rides, pay-phone con-

versations and other like goods and services have customary prices. These prices are paid year after year without any degree of bargaining. Customary prices are not subject to the rules of the game like other prices. They stand at the same level regardless of changes which take place in the value of the articles sold.

**Price Fluctuations.** Price changes are of the utmost importance to the student of economic affairs. The purchasing power of money varies with the price level and consequently all changes in the price level are translated into opposite changes in the value of money. To study price changes the Dominion Bureau of Statistics compiles index numbers of wholesale and retail prices and also of certain classes of goods. Prices must be studied by classes of goods because the changes in one class may be cancelled by changes in other classes without any change taking place in the general price level. There may be violent fluctuations in the prices of some commodities which do not appear in the general index numbers.

TABLE 9  
WHOLESALE PRICES  
1926 = 100

Year	Jan.	Feb.	Mar.	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1919..	131.9	128.4	128.2	126.8	128.9	129.1	129.8	132.5	136.8	137.0	139.2	143.0
1920..	149.4	152.9	154.5	160.7	164.3	163.3	164.1	160.2	157.2	151.3	143.7	139.1
1921..	128.4	122.3	119.1	114.9	109.2	105.3	104.8	106.0	103.5	99.6	98.3	96.4
1922..	97.1	98.3	98.3	98.4	98.5	97.8	98.7	97.1	94.4	94.8	97.2	98.0
1923..	97.0	97.1	98.3	102.4	100.4	99.6	98.3	98.3	99.0	98.0	98.1	98.3
1924..	100.4	100.4	98.8	96.7	96.4	97.5	98.5	100.4	98.5	100.5	101.0	103.0
1925..	106.0	105.4	103.5	100.2	101.7	101.5	101.2	101.7	100.0	99.9	103.2	104.7
1926..	103.0	102.2	101.3	101.2	100.2	100.1	100.0	99.1	98.5	98.1	97.7	97.9
1927..	97.8	97.6	97.3	97.3	98.3	98.7	98.5	98.3	97.1	97.2	96.9	97.2
1928..	96.9	96.8	97.7	98.3	97.9	96.9	96.0	95.3	95.4	95.2	94.9	94.6
1929..	94.0	95.0	95.6	94.5	93.4	93.4	97.2	98.4	97.8	96.8	95.7	96.0
1930..	95.3	93.9	91.8	91.2	89.7	87.7	85.3	83.7	82.1	81.0	79.5	77.7
1931..	75.9	75.5	74.5	73.9	72.5	71.8	71.3	70.5	69.7	69.9	70.7	70.4
1932..	69.4	69.2	69.1	68.4	67.7	66.6	66.6	66.8	66.9	65.0	64.8	64.0
1933..	63.9	63.6	64.4	65.4	66.9	67.6	70.5	69.4	68.9	67.9	68.7	69.0
1934..	70.6	72.1	72.0	71.1	71.1	72.1	72.0	72.3	72.0	71.4	71.2	71.2

TABLE 10  
RETAIL PRICES  
1926 =100

Year	Jan.	Feb.	Mar.	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1919..	103.7	103.1	101.8	103.1	105.0	106.3	107.0	109.6	109.6	109.6	110.2	111.5
1920..	115.5	118.1	121.3	123.3	126.5	127.9	127.9	127.2	125.9	125.2	123.3	121.3
1921..	120.0	118.1	114.2	111.5	109.6	105.7	105.0	105.6	106.3	104.4	102.4	102.4
1922..	102.4	101.1	100.5	99.2	98.5	98.5	98.5	99.2	99.2	99.2	99.2	99.2
1923..	99.8	99.8	101.1	99.8	99.2	99.2	98.5	99.8	99.8	100.5	100.5	100.5
1924..	99.8	99.8	99.2	97.8	97.2	96.5	96.5	97.8	97.8	97.8	93.5	98.5
1925..	99.2	99.8	99.2	98.5	97.8	97.8	97.8	98.5	98.5	99.2	100.5	101.1
1926..	101.0	100.8	100.8	100.4	100.2	99.9	100.1	99.9	99.2	99.1	99.4	99.8
1927..	99.6	99.3	98.8	97.9	97.8	98.0	98.3	98.1	97.9	98.2	98.4	98.8
1928..	99.4	99.0	98.6	98.5	98.1	97.9	98.1	98.9	99.0	99.7	99.5	99.5
1929..	99.3	99.0	99.2	98.6	99.0	99.0	99.2	101.0	100.8	101.1	101.4	101.6
1930..	102.1	101.9	101.5	100.4	100.2	100.2	99.5	98.9	97.2	97.0	96.9	95.9
1931..	94.9	93.9	92.2	91.5	90.2	88.7	88.6	88.9	87.7	86.3	86.4	85.9
1932..	84.8	83.8	83.3	83.1	81.2	80.4	80.1	80.8	80.4	79.8	79.9	79.5
1933..	79.1	78.4	77.8	78.0	77.0	77.0	77.2	78.6	78.8	77.9	78.1	78.4
1934..	78.2	78.7	79.9	79.4	78.5	78.2	78.4	78.7	79.0	79.3	79.4	79.0

**The Paradox of Value.** A paradox is a proposition which is true although it does not seem to be true. In spite of its seeming untruth the following statement is not false. When the quantity of a good increases beyond a certain point, its total value decreases. This can be proved by numerous cases. The Dutch traders of old who sailed spice ships from the Indies were familiar with this paradox. They jettisoned a part of their cargoes when these were too large, on the theory that what was left would be worth more than full loads.

We find a good illustration of the paradox of value in the statistics of egg production in Canada.

TABLE 11  
THE PARADOX OF VALUE

Year	Total eggs produced (Add 000 doz.)	Value (Add 000 dollars)
1928.....	268,869	\$84,443
1929.....	274,318	83,171
1930.....	278,256	74,837
1931.....	286,882	49,207

**Monopoly Price.** Any enterprise which has absolute control over the supply and demand of a commodity is able to fix the price of the commodity. Such enterprises are called monopolies. The monopolist will generally establish the price which will give him the largest net returns regardless of whether consumption is increased or decreased. We have seen that a small crop is often worth more than a large crop. Similarly 500,000 units of goods may be worth more to the monopolist than 800,000 units. The following calculation will show how the monopolist determines the price he will charge for a service or a commodity. Let us study the case of a street railway company experimenting with different rates of fare. When the fare is lowered, a larger number of passengers is carried; but after a certain point is reached, variable expenses will increase more rapidly than gross revenue, and net returns, therefore, will decrease.

TABLE 12  
MONOPOLY PRICE

Price	Number of Passengers	Gross Returns	Variable Costs Per Unit	Total Variable Costs	Fixed Costs	Total Costs	Net Returns
.10.....	500,000	\$50,000	.0350	\$17,500	\$50,000	\$67,500	-\$17,500
.09.....	700,000	63,000	.0325	22,750	50,000	72,750	-9,750
.08.....	1,000,000	80,000	.0300	30,000	50,000	80,000	—
.07.....	1,400,000	98,000	.0275	38,500	50,000	88,500	9,500
.06.....	1,900,000	114,000	.0250	47,500	50,000	97,500	16,500
.05.....	2,500,000	125,000	.0275	68,750	50,000	118,750	6,250
.04.....	3,500,000	140,000	.0300	105,000	50,000	155,000	-15,000

#### EXERCISES AND PROBLEMS

- How are goods and services exchanged in the modern world?
- What is value in use?
- What is value in exchange?
- Explain the marginal utility theory of value.
- What is price?
- What is the difference between value and price?
- Show that at any given time price is representative of value.
- State the relationships existing between supply, demand and price.
- Show that scarcity is the connecting link between supply and demand in establishing the market price of a commodity.
- Give examples of customary prices.

11. When prices are high do you get as good value for your money in spending five cents for a telephone call as when prices are low? Why or why not?
12. Draw a graph of the index numbers of wholesale prices.
13. Draw a graph of the index numbers of retail prices.
14. Write down the index numbers of wholesale prices for the last twelve months and state what group of commodities underwent the widest fluctuations in price. (Consult *Monthly Review of Business Statistics*.)
15. Name one month for which the general index number of wholesale prices was the same as for the preceding month. List the classes of commodities which rose in price and those which fell in price during that month.
16. What is a paradox?
17. What is the paradox of value?
18. Why did the old Dutch spice merchants jettison part of their cargoes in years of excessive supply?
19. Study the statistics of the Canadian wheat crop and list the years in which a small crop had a higher value than a large crop in the preceding year.
20. What is a monopoly?
21. At what price will the monopolist sell his goods?

## CHAPTER IX

### MONEY

**What is Money?** Wherever there is division of labour, goods and services must be exchanged. The most primitive method of exchange is barter, the direct trading of goods for goods, services for services, or goods for services. The drawbacks of this simple method prevented any very wide development of commerce.

1. Under this system if a member of the community wanted to exchange a measure of corn for a measure of wine, he had to find someone who possessed wine and wanted corn. This is called the double coincidence of exchange.

2. It was often impossible to trade, because some goods are indivisible. A cow could not be exchanged for a knife; and to exchange a small part of the cow for a knife meant destruction of the animal.

3. Perishable goods could not be accepted in large quantities because they could not be stored in the hope of being exchanged for other commodities.

4. When goods and services are traded directly it becomes impossible to obtain a fair deal. There are 4,950 ways of exchanging 100 different articles, and a trader, to avoid being cheated, had to be familiar with all of these combinations.

At a very remote time some commodity began to be used on one side of all exchanges. The seller received this commodity in exchange for his goods or services; he paid it out for anything which he bought. Cattle, salt, tin, iron, slaves, tobacco, skins, wampum, sugar, gold and silver served at various times and in various places, as this medium commodity to carry on trade. The word pecuniary comes from the Latin "pecus," which means cattle, the money used by the early Romans.

The way in which money overcomes the drawbacks of barter and facilitates trade gives us its definition. Money is a medium of exchange.

**Other Functions of Money.** The chief function of money is to serve as medium of exchange. There are, however, other functions of money which are very important.

1. Money is purchasing power. Each unit of money gives its holder the power to command goods in exchange to its full face value. Money is the only thing which can be universally exchanged for any article of wealth.

2. Money is a store of value. Anyone who receives money is free to postpone the exercise of the right it gives of commanding other goods in exchange. Income earned in one year can be saved, and spent the following year. It is clear, however, that a dollar saved this year will not very likely be worth the same next year. Changes in prices will make it worth more if prices fall, and less if prices rise.

3. Money is a means of payment. One may free himself from obligations incurred in the past by paying a sum of money. Money is the only legal means of meeting obligations. Fines are payable in money. In many cases of bankruptcy, the inventory shows an excess of assets over liabilities, but merchandise on hand is of relatively small value in freeing a debtor from his obligations. Money alone will make him solvent.

4. Money is a measure of value. The purchasing power of the dollar is a measure of the value of anything which has a price. In turn the value of money depends on the prices of all articles of trade. Value of money and prices are reciprocally related. The index of the value of money is a reciprocal of the price index.

**Qualities of a Good Money.** Gold and silver are practically the only two commodities which have withstood the test of time and which are still used as money on a large scale. The reason why the other kinds of money have been abandoned is because they did not fulfil all the conditions required of a commodity before it can be used as money. These qualities are: (1) Portability. (2) Durability. (3) Uniformity. (4) Cognizability. (5) Divisibility.

1. Portability. The article used as money must be of sufficient value to make a small quantity worth comparatively a great deal. Gold answers this requirement as it may be easily carried from place to place.

2. Durability. Perishable goods cannot be used as money. Iron rusts and loses weight. Anything which loses value over a period of time is a poor money material. Gold is one of the most durable materials known. It does not rust like iron. Gold coins twenty-five centuries old have been unearthed and found to be the same as they were the day they were minted.

3. Uniformity. Any material used as money must be of uniform quality throughout. Gold, when it is refined at the mint, is of uniform quality.

4. Cognizability. Money must be easily recognized. The precious metals, because of their sheen, are seldom mistaken for other metals. The senses of hearing and of touch also can detect gold and silver.

5. Divisibility. Cattle are not divisible unless slaughtered. Then the parts become perishable and they are no longer useful as money. Gold and silver are simply melted down and coined into as many parts as are convenient.

**Money and Price Relationships.** The relationships between money and prices can be briefly stated as follows:

1. When prices rise, the value of money declines.
2. When prices fall, the value of money increases.
3. When the quantity of money is increased, prices rise.
4. When the quantity of money is decreased, prices fall.

By value of money we mean the purchasing power of money. This purchasing power of the dollar is never stationary. It is always moving in a direction opposite to that of prices. Comparatively few people are aware of the fact that the dollar is always changing in value. Unknown to them, investors loan long dollars and are paid back short dollars. Those who invest their savings in bonds, debentures, mortgages, bank accounts and all other investments with a fixed rate of returns, lose when prices rise and gain when prices fall.

TABLE 13

PURCHASING POWER OF THE CANADIAN DOLLAR EXPRESSED  
IN TERMS OF WHOLESALE PRICES

	Canadian Farm Products	Foods, Beverages and Tobacco	Textiles and Textile Products	Coal	General Wholesale Prices
1913.....	1.597	1.618	1.718	2.128	1.563
1914.....	1.445	1.534	1.757	2.160	1.527
1915.....	1.287	1.458	1.715	2.169	1.420
1916.....	1.115	1.224	1.289	2.053	1.186
1917.....	.769	.914	.873	1.647	.875
1918.....	.752	.838	.637	1.410	.785
1919.....	.687	.780	.611	1.206	.746
1920.....	.619	.662	.567	1.000	.641
1921.....	.973	.949	1.042	.898	.909
1922.....	1.153	1.109	.983	.992	1.028
1923.....	1.253	1.096	.855	.976	1.020
1924.....	1.149	1.106	.848	.976	1.006
1925.....	.996	1.024	.889	.995	.975
1926.....	1.000	1.000	1.000	1.000	1.000
1927.....	.979	1.006	1.067	.982	1.024
1928.....	.993	1.004	1.058	1.049	1.037
1929.....	.992	1.000	1.095	1.046	1.046
1930.....	1.215	1.074	1.222	1.060	1.155
1931.....	1.776	1.420	1.362	1.074	1.387
1932.....	2.066	1.626	1.435	1.099	1.499
1933.....	1.961	1.567	1.435	1.143	1.490
1934, January.....	1.808	1.447	1.379	1.126	1.416
February.....	1.724	1.368	1.355	1.127	1.387
March.....	1.770	1.379	1.348	1.129	1.389
April.....	1.805	1.431	1.355	1.145	1.406
May.....	1.757	1.471	1.357	1.120	1.406
June.....	1.686	1.439	1.339	1.115	1.387
July.....	1.667	1.445	1.353	1.102	1.389
August.....	1.623	1.451	1.359	1.099	1.383
September.....	1.631	1.441	1.374	1.126	1.389
October.....	1.642	1.447	1.379	1.127	1.401
November.....	1.634	1.466	1.381	1.129	1.404
December.....	1.623	1.473	1.377	1.145	1.404

Labour is usually paid wages which change very slowly. When prices rise labour's wages will buy less, while lower prices will mean more purchasing power to labour.

The taxpayer who pays a fixed assessment really pays more when prices are low than when prices are high. Governments find it much more difficult to collect the same number of tax dollars when prices are low than when prices are high.

Changes in the price level are partly the result of changes in the quantity of goods and services produced, and partly the result of changes in the quantity of money in circulation. One side is just as important as the other in bringing about changes in the price level.

Monetary and price changes are measured by means of index numbers. This device has been explained under Production in Chapter III.

**Kinds of Money.** There are several classes of money in use to-day.

1. Metallic money.
  - (a) Gold coin and bullion.
  - (b) Silver coin and bullion.
  - (c) Subsidiary coin of nickel, aluminum, bronze and of various kinds of alloy.
2. Credit money.
  - (a) Representative money.
  - (b) Fiduciary money.
  - (c) Fiat money.
  - (d) Bank money.
    - (1) Bank notes.
    - (2) Bank deposits.
  - (e) Book credit.

*Gold.* Monetary gold is used to-day chiefly in the form of bullion. Gold bars are stored in vaults and enter circulation only when large payments are made. The fineness of the gold and the weight of each bar is carefully ascertained before a shipment is made and upon its receipt. Gold 1,000 fine is pure gold. Gold nine-tenths fine contains nine parts of gold to one part of other metal. Troy weight or the metric system is used to weigh gold. The principal functions of gold in a modern community are the settling of international balances and its use as the basis, standard, or regulator of other kinds of money not only within the country, but also between countries. Gold is seldom coined, to-day, on account of the loss due to wear. No gold coins have been struck in Canada since 1919. At the old price of gold, \$20.67 an ounce, the Canadian gold dollar was equivalent to 25.8 grains, nine-tenths fine, or 23.22 grains of pure gold. The Royal Mint, Ottawa, issued five-dollar and ten-dollar gold pieces of the above fineness.

*Silver.* This metal was once generally used, side by side with gold, as a basis for other kinds of money. Its value was then about one-fifteenth that of gold. Wide changes in the

value of silver brought about a considerable demonetization of this metal in practically all countries but China. It is now coming back into its own, owing to the world shortage of gold. In Canada, silver dollars weighing 360 grains, eight-tenths fine have recently been coined. Fifty, twenty-five and ten-cent pieces of the same fineness and of weight proportionate to their respective fractions of the dollar are in general circulation. These coins are subsidiary coins and the value of their silver content is much smaller than their face value. They are therefore worth more as money than as wealth.

*Nickel and Bronze Coins.* A five-cent piece containing seventy grains of pure nickel has been struck at the Mint since 1922. Bronze one-cent pieces are also in circulation.

*Coinage.* Coins were first struck as a guarantee of the weight and fineness of the currency. In all civilized countries coinage

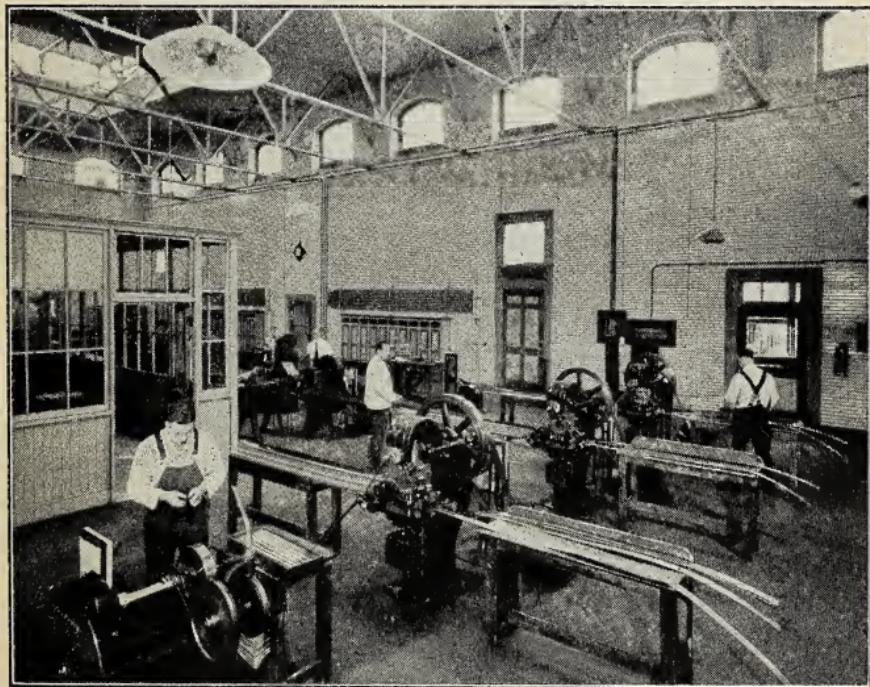


FIG. 14. STAMPING COINS AT THE MINT

is considered as one of the attributes of sovereignty and is restricted to the central government. In Canada this process is carried on at the Royal Canadian Mint. In some countries anyone is allowed to bring bullion to the mint to be converted into coin. This is called free coinage, but not in the sense that the service is rendered without charge. The term simply means that anyone is free to bring bullion to be turned into coin. When no fee is imposed, coinage is said to be gratuitous. When the cost of minting is assessed to the individual the charge is called brassage. Any additional levy is known as seigniorage.

*Credit Money.* In the remote past, metallic money was practically the only form of currency. In the present economic system, metallic money forms a small proportion of the currency. People have become accustomed to accepting a promise to be paid instead of immediate payment. Now, a promise to pay means a debt; from another viewpoint it means a debtor and a creditor. This is better explained by an illustration. A customer who purchases a dollar article becomes indebted to the storekeeper to the amount of the price charged. Although this debt may be immediately discharged by actually handing over the counter one dollar, no matter how soon the debt is discharged a debt actually existed. To settle debts we sometimes have recourse to a process of cancellation. If A owes B \$500 and C owes A \$500, A may discharge his debt to B without the use of money provided B consents to accept C as his debtor. In the same way the customer may discharge his debt to the storekeeper by having the latter accept the government as his debtor. We assume that the customer has a one-dollar Bank of Canada note which is the Central Bank's promise to pay him one dollar. The storekeeper willingly accepts the Central Bank as his debtor for one dollar and the transaction is closed when he takes the dollar bill. This Bank of Canada note is credit money.

The three important kinds of credit money are Central Bank or government notes which serve as the basis of other kinds of credit money, bank notes, and bank deposits. In Canada,

there are no government notes with the exception of outstanding Dominion notes.

*Bank of Canada Notes.* The Bank of Canada Act provides for the issue of Bank of Canada notes to any amount. These notes replace Dominion notes and part of the bank notes in circulation. They are secured by the Central Bank's reserves.

*Bank Notes.* Canadian chartered banks are authorized to issue notes of \$5, or in multiples of five, to the amount of their paid-up capital. The Bank Act, 1934, provides for the gradual withdrawal of bank notes from circulation. (1) The maximum amount of notes of a bank in circulation must not exceed its paid-up capital on and after the day the Bank of Canada is authorized to commence business. (2) During a five-year period beginning January 1, 1936, this maximum must be reduced by five per cent. per year on the first day of each year. (3) During a five-year period beginning January 1, 1941, this maximum must be further reduced by ten per cent. per year on the first day of each year. After these reductions the maximum amount of bank notes in circulation will not exceed twenty-five per cent. of the banks' paid-up capital.

**Gresham's Law.** When Canadian money is at a premium in New York there is a flood of American silver coins at all Canadian border points. Canadian silver coins become more and more scarce until most of our metallic money is out of the local circulation. The cheaper money has driven out the good money. We have an illustration of the same phenomenon when a person inadvertently accepts a coin which does not seem to be just right. This coin will be the first spent. Individuals naturally spend first that money which has the least value. This keeps the best money out of circulation. During the reign of Elizabeth, sweated coins were driving good coins out of England. This was observed by Sir Thomas Gresham, who formulated the law which has taken his name. Bad money tends to drive good money out of circulation.

**The Quantity Theory of Money.** An increase of the quantity of money in circulation increases the purchasing

power in the hands of the people; more money is spent. Additional spending means the bidding up of prices. When prices rise, because of an increase in money in circulation, the change is described as inflation. A contraction of the volume of money in circulation removes purchasing power from the hands of the people who are compelled to curtail their spending. As a consequence, prices fall. When people are using their money to pay debts instead of using it to buy goods the result is the same; prices fall. Such action on the part of the people to reduce the volume of indebtedness or credit is called debt liquidation. The combined effect of debt liquidation and contraction of the volume of money in circulation is a fall in the price level. This is called deflation.

The speed at which money circulates is also of importance. Rapidly circulating money has more effect on the price level than slowly circulating money. A piece of money which changes hands twice in one day does the same work as another coin does in two days if the latter changes hands only once a day. Hence, the velocity of circulation affects the price level in the same way as the quantity of money in circulation.

The amount of work to be done by the money in circulation is another factor which must be considered. An increase in the volume of trade, unaccompanied by an increase in the quantity of money or in the velocity of circulation, causes prices to fall. A decrease in the volume of trade, unaccompanied by a decrease in the quantity of money in circulation or in the velocity of circulation, causes prices to rise.

These relationships are expressed in the following formula in which M stands for the quantity of money in circulation, V denotes the velocity of circulation, T stands for the volume of trade and P represents the general price level.

$$MV = PT$$

#### EXERCISES AND PROBLEMS

1. What is money?
2. What is barter?
3. What are the disadvantages of the barter method of exchange?
4. State and explain the functions of money.

5. What are the qualities of a good money?
6. State the relationships between money and prices.
7. Why is monetary gold used chiefly in the form of bullion?
8. Why are Canadian silver coins worth more as money than as wealth?
9. When silver is worth 75 cents an ounce, what is the value of the silver contents of a 50 cent piece? Of a 25 cent piece? Of a 10 cent piece?  
(1 ounce = 480 grains.)
10. Explain free coinage, brassage and seigniorage.
11. What is credit money?
12. What are Bank of Canada notes?
13. On what date did the Bank of Canada commence business?
14. What are bank notes?
15. What provisions are made in the Bank Act, 1934, for the withdrawal of bank notes?
16. If a bank has a paid-up capital of \$5,000,000 and a rest or reserve fund of equal amount, what is the maximum amount of notes which the bank may have in circulation on the following dates:
  - (1) On the day the Bank of Canada commenced business?
  - (2) On February 1, 1937?
  - (3) On February 1, 1942?
  - (4) On February 1, 1947?
17. What is Gresham's Law?
18. What is inflation?
19. What is deflation?
20. Explain the quantity theory of money.

## CHAPTER X

### CREDIT

**Credit as an Extension of Exchange.** In early times credit was a promise to give future goods and services in exchange for present goods and services. If a weaver, who could not pay for it immediately, bought wool from a sheep grazer and paid for it later in woollen cloth, the exchange was made on a purely credit basis. The practice of making loans developed from this sort of exchange of goods or services. A farmer lent fifty bushels of wheat to a neighbour, who paid back in kind at harvest time. He exchanged for the wheat he had borrowed for seeding new wheat from the harvest. To-day, instead of actually exchanging present goods and services for future goods and services, we obtain rights to claim goods and services in the present by granting rights to claim goods and services in the future. In other words, credit is given and taken in terms of money or currency. Put in another way, credit is the other side of a debt: the creditor consents to assign his claims to goods and services to a debtor who undertakes to repay these claims at some future date.

**Characteristics of Credit.** 1. Consumption of what is sold or loaned is an essential characteristic of credit. The buyer or the borrower immediately proceeds to destroy, transform, manufacture, or otherwise consume whatever is bought on credit or borrowed. The farmer sows borrowed wheat while the miller transforms into flour wheat bought on credit. A loan obtained at a bank is spent to the last dollar. 2. Waiting, on the part of the lender or the seller, to be repaid is another important characteristic of credit. Wheat has to be harvested before it can be repaid. The banker must wait till the borrower has made enough money, by spending the proceeds of the loan, to repay the bank. The merchant must wait till the customer gets a pay cheque. This explains the need of confidence on the part of both borrower and lender.

(a) The lender is confident that the borrower will receive income sufficient to repay his loan. However, the expected income is only expected income. It is non-existent. It has yet to be earned. The whole solution of whether he will be repaid lies in the future. Hence, the lender must have confidence in the future. That is why we use the term credit, derived from the Latin "credimus," part of the verb "credere," to believe.

The law protects creditors. Endorsements, mortgages and covenants, binding the endorser, the mortgagor and covenanter, even unto his freedom in certain countries, are ample evidence of the legislator's solicitude in that respect.

(b) The borrower must utilize a loan in a way which will make repayment possible. If he uses the proceeds for unproductive purposes, that is, if he borrows to live, he will soon find himself facing disaster. The records of our courts relate the tragic outcomes of unfortunate borrowings.

**Instruments of Credit.** 1. *The Promissory Note.* As long as man lived under the agricultural stage, specialization was limited. The individual seldom bought goods from merchants coming from afar and seldom sold his produce to strangers. With the development of means of communication business became more general. That meant a finer division of labour. A higher degree of specialization brought about a greater number

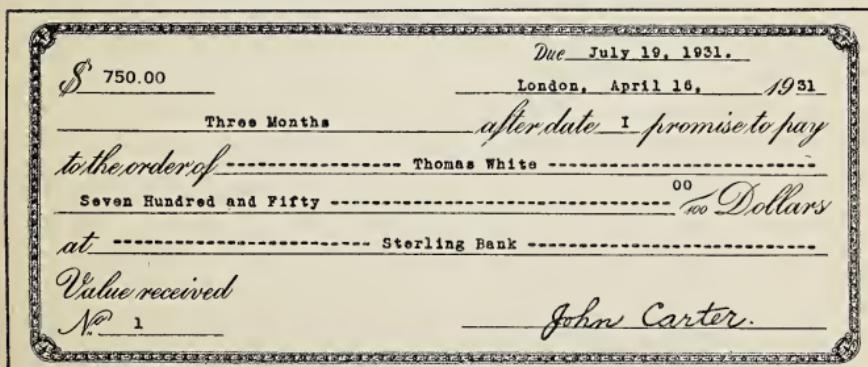


FIG. 15. A PROMISSORY NOTE

of transactions and the necessity of dealing with a greater number of people. As specialization spread over several villages business had to be carried on with strangers. It then became necessary to change from the oral promise to pay to the written promise to pay. This written promise to pay was an instrument of credit. Courts of law enforced the collection of written promises to pay. Since resort could be had to a tribunal to enforce the execution of contracts, even persons who were suspected of dishonesty could be granted credit provided they signed a promise to pay.

2. *Paper Money.* Governments have always been large users of credit. In times of war they borrowed gold and silver from wealthy merchants or noblemen. Because government loans had to be repaid from tax moneys, or from new loans, kings or emperors often found it impossible to tax sufficiently, or to make new loans to repay old loans. They then had recourse to promissory notes of small denominations, bearing no interest. These passed freely from hand to hand. That was the beginning of paper money.

3. *Bank Notes.* Towards the end of the thirteenth century there was established in London a colony of Lombard merchants who combined the goldsmith's art with the business of banking. They accepted deposits and gave deposit receipts in return. These receipts, called goldsmiths' notes, were the first bank notes. They circulated freely in the community and in their acceptance was embodied the faith of the people in the bankers' integrity.

4. *Orders to pay.* These are drawn upon (1) a debtor, or (2) a person, or bank, holding money on deposit.

(a) The draft. This is an order to pay, drawn upon a debtor and ordering him to pay a sum of money to a third person either on demand or after a specified period of time. The origin of drafts, or bills of exchange, may be found in the history of early trading centres. A Venetian merchant, A, who owed 1,000 ducats to another merchant, B, in Amsterdam, had to ship gold or silver. However, prevalence of piracy on sea and of highway

robbery on land made such shipments very uncertain. Instead of sending specie, A, the debtor, sought out another Venetian merchant, C, who had a debtor, D, in Amsterdam, owing the same amount. A paid gold to C. C wrote a letter to D in

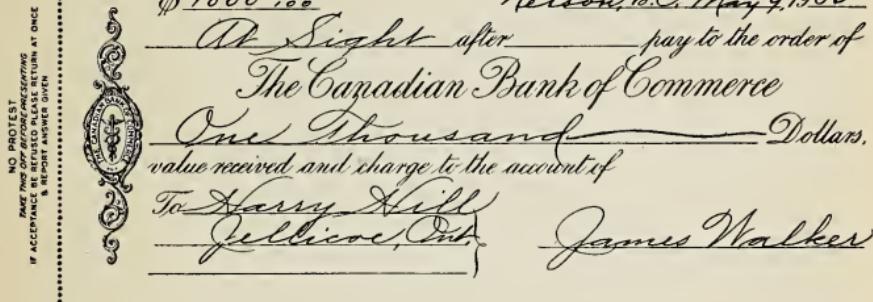


FIG. 16. A DRAFT

Amsterdam ordering him to pay B 1,000 gold ducats. This letter was sent by A to B who presented it to D in Amsterdam and collected the 1,000 ducats.

Let us suppose that Harry Hill buys a carload of lumber worth \$1,000 from James Walker on credit. Walker becomes a creditor and Hill becomes a debtor. Now Walker may order Hill to pay at sight to Walker's bank the sum owing. When Hill receives a notice from the bank that Walker has drawn a draft on him he goes to the bank and writes "Accepted" along with his signature, across the face of the draft. Since this draft is an order to pay at sight, Hill pays the bank \$1,000.

Note that there are three parties to this credit transaction. Walker draws the draft and is called the *drawer*. The draft is drawn on Hill, the *drawee*. The money is to be paid to the Bank of York, the *payee*. Since Hill accepts the draft he is also called the *acceptor*.

(b) The cheque. A bank depositor is entitled to withdraw the funds he has on deposit or to transfer all or part of his deposit to a third party. Bank deposits are the chief kind of money in use in Canada. In at least nine-tenths of our transactions we transfer bank deposits from one depositor to another.

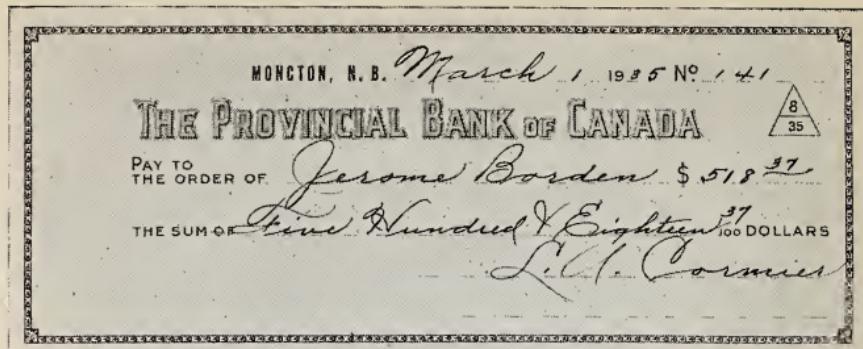


FIG. 17. A CHEQUE

To make these transfers we issue cheques or written orders to pay, ordering our bank to pay a sum of money to a third person, to his order, or to bearer.

Grain tickets used by grain dealers as a means of paying farmers are accepted by banks in the same way as cheques. They are used to transfer money on deposit from one person to another and, therefore, fill the same function as the cheque.

**Long Term Credit.** The instruments of credit described in the preceding paragraphs are used only in transactions in which short term credit is involved. Short term credit is usually liquidated or renewed thirty, sixty or ninety days after it is created. The time of a short term credit loan seldom exceeds a year. Short term accommodation corresponds to circulating capital in industry. Fixed capital must also be financed. Evidently funds invested in fixed capital cannot be expected to be repaid as quickly as funds invested in circulating capital which changes hands in a very limited time. Fixed capital remains in the ownership of the firm. To sell fixed capital after a short while to repay a loan made to purchase plant and equipment would defeat the purpose of the loan. Money borrowed to finance the building and equipping of a plant is therefore borrowed over a long period of time. This period varies with the durability of the fixed capital involved: an issue of bonds to build a concrete dam on a power site will be made on

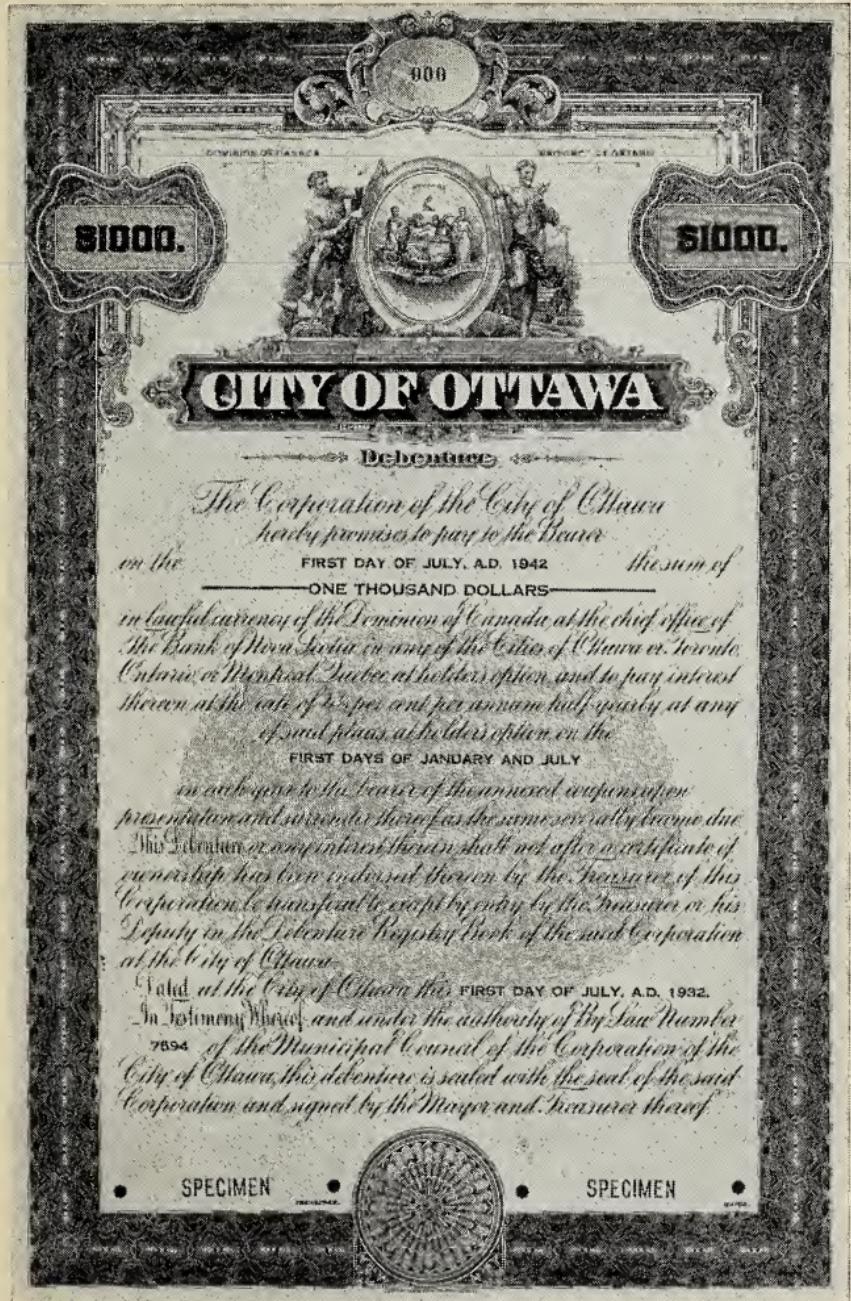


FIG. 18. A BOND



FIG. 18A. SPECIMEN COUPONS

longer terms than will bonds issued to build a hockey arena of wooden construction.

Long term loans are made in exchange for a pledge or mortgage of the assets of the borrowing corporation. A credit instrument is usually drawn for the full amount of the loan. A trustee is appointed and bonds of various denominations are issued up to the value of the loan. The nature of the loan and other details of importance, such as the rate of interest, the time and the place of interest payment, are advertised in a prospectus. At the same time the bonds are allotted to various brokers and investment houses who sell them to the public.

Government bonds are issued by the Dominion, provincial and municipal governments. Government bonds are issued to finance buildings and improvements and for public ownership enterprises. In times of war or urgent public need, bonds are sold to meet current expenditures.

**Consumption Loans.** Durable consumption goods such as homes, automobiles, furniture and other high-priced articles, are sold on a credit basis. Cash sales are not uncommon, but a large part of present-day business in goods of this class is

arranged on the instalment plan. The customer pays so much down and so much per week or per month. Title to the goods does not usually pass to the buyer until the last payment is made. Real estate sold on the instalment basis is transferred immediately, after a mortgage has been executed as a guarantee.

An unfavourable feature of instalment buying is the practice of adding exorbitant carrying charges to cash prices. A justification of this policy may be found in the need of covering losses incurred when goods are repossessed or when the customer moves without having made known his destination.

Before buying anything on the instalment plan the consumer should ascertain his future income. Instances are known of individuals of moderate income who undertook to pay instalments totalling more than their income. Hardship must necessarily follow such improvident purchasing. The alert consumer makes his purchases only after he has saved sufficient money. Cash purchases are, not infrequently, made preferable by substantial discounts from marked prices. Unfortunately, there are many who have no incentive to save, whose incomes no more than cover their current expenditures. The ability to acquire desired articles of consumption in exchange for a small consideration is a powerful incentive to enter into a contract which predetermines the amount that will have to be saved out of each salary-cheque. Since, then, many instalment buyers are enabled to diversify their consumption by acquiring a wider variety of goods for which they would be too improvident to save, the practice of buying on time must be credited with a decisive victory over the shiftlessness of the spendthrift.

#### EXERCISES AND PROBLEMS

1. What is credit? What is a debt? Who is the creditor? Who is the debtor?
2. State the essential characteristics of credit.
3. Why must the lender have confidence in the future?
4. What is a promissory note? Write out a promissory note.
5. What is the origin of paper money? What is the origin of bank notes?
6. What is an order to pay? What is a draft? What is a cheque?
7. What is long term credit? What is short term credit?
8. What is a financial prospectus?
9. Give five examples of consumption loans.
10. What are the (a) disadvantages, (b) advantages, of instalment buying?

## CHAPTER XI

### BANKING

**Savings Banking.** Savings banking is a method of managing the money funds of the people. Money income earned for owning or for doing things is not always used exclusively for purchasing goods for immediate consumption. Many people instead of spending all of their money save part of it. However, if this money is not spent, the economic system will be upset, since all disbursements made by enterprisers, the chief source of income, must come back to them as the selling proceeds of their output. It is indeed obvious that when the enterprisers take in less than they pay out—that is, when they cannot sell their goods—they are forced to curtail production and discharge some, and sometimes all, of their employees. Fortunately, when people have more money than they need they either invest it or put it back into circulation through the banks. It is the function of the banks to lend these savings so that they may be spent at the earliest possible opportunity, preventing goods from accumulating on store shelves or in warehouses, and also, which is far more important, keeping industry from coming to a stop.

When savings are deposited in a bank an entry is made in a ledger under the name of the depositor. In other words, deposited money is entered in the depositor's account and becomes a deposit, or, what we sometimes call "money in the bank," a part of the huge fund which is constantly circulated to keep things moving from the extractive industries, through manufacturing, transportation, storage and marketing, onward to the consumer.

**Commercial Banking.** Commercial banking is the art of managing the money fund of business. You have learned that we live in an age of great specialization. In the production of bread we depend on the services of the farmer, the grain dealer,

the speculator, the miller, the baker, the railway and the elevator employees and the storekeeper. They all do their share. At many points in the production of bread the product changes hands and becomes the property of a new enterpriser. Every time that this takes place money is used. When the grain dealer buys the farmer's wheat, he orders his bank by means of a cheque to pay over to the farmer a part of his "money in the bank." This is repeated every time the product changes hands. Consequently the banks are constantly taking money from someone's deposit to transfer it to some other account. When the grain-dealer's account runs out, the bank lends him more money on the security of wheat which he stores in elevators. When the wheat is sold the bank will be repaid and the same money will be used over and over again. This is the function of commercial banking: to insure, by lending the money of people who do not need it to people who need it, that the money fund will be used again and again to keep production going.

**Deposits.** Banks accept money to be kept on deposit. When a customer deposits money he fills out a deposit slip on which he lists the items he wishes to convert into a bank deposit. Let us assume that on October 5, 1933, F. C. Anderson deposits a sum of money consisting of various items. He fills out a deposit slip which is handed to the teller or cashier who checks over the items. These items are now the property of the bank. The slip is stamped and handed to the ledger-keeper, who writes the total sum, \$137.55, to F. C. Anderson's account. The bank now owes Anderson \$137.55, which at any time, by issuing a cheque, he may order the bank to pay to himself or to a third party.

This deposit may be used as a medium of exchange in the same way as coin or Bank of Canada notes. Bank deposits are credits which can be used to cancel debts. They are the chief form of credit money in use in the modern world. The only difference between a bank deposit and a Bank of Canada note lies in the fact that the former is a chartered bank debt while the latter is a Central Bank debt. That Bank of Canada notes are

FORM S. 6

The  
Province of Ontario Savings Office

SAVINGS BANK DEPARTMENT

Account No. A 473

Credit F. C. Anderson

---

Deposited by F. C. A.

Oct. 5, 1933

---

4	X	1 =	4
	X	2 =	
	X	4 =	
2	X	5 =	10
7	X	10 =	70
	X	20 =	
	X	50 =	
	X	100 =	
<i>Gold</i>			- - -
<i>Silver</i>			10 55
<i>Cheques</i>			25
			18
			<hr/> \$ 137 55

FIG. 19. A DEPOSIT SLIP

elaborately engraved, whereas bank deposits are represented only by scrawls on a bank ledger, is a mere matter of form.

Deposits are usually of two kinds, demand deposits and time deposits. A demand deposit is payable on demand. A time deposit, or notice deposit, is payable only after a certain number of days, after notice of withdrawing all or part of the deposit has been given. Bank customers with current accounts make demand deposits. Those with savings accounts have time deposits.

**Loans and Discounts.** We may consider deposits as borrowings made by the banks. Obviously if the bank borrows, the bank will have to lend. A certain sum will be kept as a reserve against deposits and the balance will be lent or invested. Bank loans are commonly made by discounting commercial paper.

Suppose a business man needs \$2,000 to finance additional stock for the Easter season. Since his credit at the bank is good, he knows he will be granted accommodation. He signs a sixty-day promissory note, which he sends to the bank. Upon receiving it, the bank enters to his credit an amount equal to the present value of the note. To arrive at this present value the bank deducts a certain sum from the face value. The amount deducted is called bank discount. Bank discount is interest paid in advance.

Collateral loans are loans made against the security of stocks, bonds, insurance policies and warehouse receipts. Such loans are never made to the full value of the security posted. When collateral decreases in value the borrower is expected to reduce his indebtedness or to increase his collateral. Except to protect previous loans, Canadian banks are not allowed to accept mortgages as collateral.

**The Volume of Deposits.** Bank deposits are money; as such they influence prices. An expansion of bank deposits has a tendency to raise prices, whereas a contraction of bank deposits has the opposite effect. It is important, therefore, to know the causes of changes in the volume of bank deposits.

In 1867 the total on deposit in Canadian banks was \$31,375,316, about one-sixtieth of the 1934 level. Several factors are responsible for this increase.

(a) *Loans and Discounts.* When a bank makes a loan, a bank deposit is created; when the loan is repaid the deposit is cancelled. Suppose a customer borrows \$1,000 from his bank. Either he is given a credit which is entered in his deposit account or he is given bank notes. If he is given a credit, deposits are immediately increased. If he is given bank notes, he pays them out. Those who receive these notes deposit them and deposits are increased. During the period of the loan the borrower builds up his deposit at the expense of other deposits. When he has accumulated \$1,000 he repays the loan. This cancels the \$1,000 deposit. Consequently, when bank loans are made more rapidly than they are repaid, deposits are increasing; when bank loans are repaid more rapidly than they are made, deposits are decreasing.

(b) *Bank Investments.* When a bank buys anything, from a pen to a block of government bonds, deposits are increased. The sale of anything by a bank decreases deposits.

(c) *Foreign exchange transactions.* Money sent out of a country decreases deposits in the remitting country and increases deposits in the country of destination.

(d) Fees and interest collected by banks decrease deposits.

(e) Salaries and wages, rent, interest, dividends and taxes paid by banks increase deposits.

(f) Deposits between banks are created when one bank deposits with another.

**Assets and Liabilities.** Assets is the term used to denote what is owned and liabilities means what is owed. The banks owe all the money deposited with them, their own bank notes in circulation and the capital subscribed by the shareholders; they own cash, such as gold, Bank of Canada notes and coin which they keep in quantities sufficient to meet demands. They also own, besides their office buildings and sites, securities and com-

TABLE 14

## THE PROVINCIAL BANK OF CANADA

General Statement, 30th November, 1934

	<i>Assets</i>	
Gold and Coin.....	\$260,660.96	
Dominion Notes.....	1,514,694.25	
Notes of Other Banks.....	268,415.00	
United States and other Foreign Currencies.....	51,422.00	
Cheques on other Banks.....	1,532,988.08	
Due by other Banks in Canada.....	508,769.90	
Due by Banks (elsewhere than in Canada).....	199,765.19	
		4,336,715.38
Dominion, Provincial Government Securities and Municipal Securities.....	16,959,828.27	
Bonds, Debentures and Stocks.....	2,774,245.74	
Call and short loans.....	4,825,943.74	
Deposit with the Minister of Finance.....	192,400.00	
		29,089,133.13
Other current Loans and Discounts.....	14,332,087.57	
Bank Premises.....	2,127,426.56	
Letters of Credit as per contra.....	29,675.08	
Non-current loans.....	153,643.53	
Real Estate other than Bank Premises.....	612,339.91	
Mortgages on Real Estate sold by the Bank.....	375,756.08	
Other Assets.....	79,820.97	
		46,799,882.83
	<i>Liabilities</i>	
Demand Deposits.....	\$4,205,605.19	
Time Deposits.....	32,087,893.52	
Deposits by and balances due to Dominion Government.....	453,646.61	
Deposits by and balances due to Provincial Government.....	46,158.47	
Advances under the Finance Act.....	600,000.00	
Balances due to Banks (elsewhere than in Canada).....	30,907.27	
		37,424,211.06
Notes of the Bank in circulation.....	3,984,386.50	
Letters of Credit outstanding.....	29,675.08	
Other Liabilities.....	12,052.44	
		41,450,325.08
Dividends declared and unpaid.....	63,816.92	
Capital Paid Up.....	4,000,000.00	
Reserve Fund.....	1,000,000.00	
Balance of Profit and Loss Account carried forward.....	285,740.83	
		46,799,882.83

mercial paper. Commercial paper represents the loans made by the banks. A careful study of the above balance sheet will reveal the various items owned and owed by the banks.

**The Canadian Banks.** We have ten banks in Canada. They hold charters from the Parliament of Canada and for that reason they are called chartered banks. To obtain a charter to start a new bank many conditions must be fulfilled. Our banking law is framed to give depositors the greatest possible protection. Making difficult the obtaining of a charter is one method of protecting the people.

TABLE 15

STATISTICS OF INDIVIDUAL CHARTERED BANKS AS AT  
OCT. 31, 1934, WITH TOTALS 1900-34

Bank	Branches in Canada and Abroad	Total Assets	Liabilities to Shareholders	Liabilities to the Public	Total Liabilities	Loans and Discounts	Deposits by the Public
	No.	\$ 000,000	\$ 000,000	\$ 000,000	\$ 000,000	\$ 000,000	\$ 000,000
Bank of Montreal.....	553	759	74	683	757	284	622
Bank of Nova Scotia.....	317	277	36	239	275	126	213
Bank of Toronto.....	179	116	15	100	115	61	89
Provincial Bank of Canada.....	136	50	5	45	50	20	38
Canadian Bank of Commerce.....	647	574	50	520	570	285	464
Royal Bank of Canada....	789	748	55	689	744	403	616
Dominion Bank.....	133	120	14	105	119	69	92
Banque Canadienne Nationale.....	242	127	12	114	126	62	103
Imperial Bank of Canada.....	198	136	15	121	136	77	107
Barclay's Bank (Can.)*..	4	14	2	12	14	2	7
Totals, Oct. 1934.....	3,198	2,921	278	2,628	2,906	1,389	2,351
Totals, 1933.....	3,198	2,831	302	2,518	2,820	1,409	2,237
Totals, 1932.....	3,319	2,869	307	2,546	2,853	1,583	2,257
Totals, 1931.....	3,506	3,066	307	2,742	3,048	1,764	2,423
Totals, 1930.....	3,598	3,237	305	2,910	3,215	2,065	2,517
Totals, 1920.....	4,876	3,064	252	2,784	3,036	1,935	2,438
Totals, 1910.....	2,621	1,211	179	1,019	1,198	870	910
Totals, 1900.....	641	460	98	356	454	279	305

\*As at Jan. 1, 1934. Does not include sub-agencies.

Our banking system is called branch-banking. Each bank has many branches spread throughout the country. This arrangement allows the movement of funds from one place to another as the need arises. Where there is individual banking, such as exists in the United States, this transfer cannot be effected very readily. Weak spots in the economic system may cause whole regions of bank failures. When a weak spot develops in our economy, our branch-banking system overcomes the emergency by bringing in funds from more prosperous districts. However, branch banking has been accused of draining funds from certain parts to use them in preferred places and of serving big commercial concerns, such as the chain-store, at the expense of small enterprises.

Besides our chartered banks we have the Post Office Savings Bank, the deposits in which are a direct obligation of the Dominion Government. In Ontario and Alberta there are Government Savings Offices operated by the Provincial Governments. In the Province of Quebec there are two important savings banks, the Montreal City and District Savings Bank and La Caisse d'Economie de Notre-Dame de Québec. Les Caisses Populaires, which are co-operative people's banks, are found in nearly every Quebec village and town. In 1932 there were 40,933 members of these mutual savings banks. They had 40,201 depositors and 12,363 borrowers. Their loans on notes and mortgages, and their debenture investments totalled \$8,605,440.

**The Clearing House.** When you draw a cheque ordering your bank to pay \$10 to Mr. X, who deposits with another bank, a problem arises. The other bank must collect \$10 from your bank.

Before the clearing house practice was established, the banks sent their messengers to make these collections. One day, in London, two messengers met in a coffee-house. Their conversation became so absorbing that they forgot to finish their rounds until they realized it was too late. They struck the idea of transacting their business on the spot. The next day more messengers met at the coffee-house to settle claims between banks and found that they could settle all their business in record time without having to walk from one office to another. That was the beginning of the clearing-house.

The following example suggests the method used at the present time. A, B, C, D and E are five banks which settle their claims through a clearing house. Sums owing are deducted from sums owing to, or vice versa, whichever is greater, leaving a balance to be received from, or to be paid into, the clearing.

With the old method of collecting by messenger the five banks would have needed \$119,949.11 to discharge their mutual obligations; the clearing house method requires only \$9,704.84, a tremendous saving.

TABLE 16  
THE CLEARING HOUSE BALANCE

Claims by.....	A	B	C	D	E	
Claims against A	<hr/>	2,992.24	5,985.36	6,973.57	7,333.60	= 23,284.77
B	10,000.11	<hr/>	9,139.13	7,878.31	1,009.10	= 28,026.65
C	9,581.00	4,563.31	<hr/>	2,143.17	5,613.85	= 21,901.33
D	1,379.17	8,359.12	6,115.03	<hr/>	8,970.31	= 24,823.63
E	7,673.92	5,116.59	4,003.09	5,119.13	<hr/>	= 21,912.73
	+28,634.20	+21,031.26	+25,242.61	+22,114.18	+22,926.86	= 119,949.11
	-23,284.77	-28,026.65	-21,901.33	-24,823.63	-21,912.73	
	+ 5,349.43	- 6,995.39	+ 3,341.28	- 2,709.45	+ 1,014.13	
A receives.....	5,349.43		B pays.....		6,995.39	
C receives.....	3,341.28		D pays.....		2,709.45	
E receives.....	1,014.13					
	<hr/>	9,704.84			<hr/>	9,704.84

**The Bank's Reserve.** The cash reserve of a bank is that part of the assets which is immediately available for meeting demands over the counter, or from other banks through the clearing house. Banks usually expand their credit to nine or ten times the amount of their cash. The supply of cash is usually determined by the Central Bank or by the central note-issuing authority.

An increase in the note circulation places the banks in a position to increase their cash reserves. Any restriction in the note issue has the opposite effect. Since the volume of deposits cannot be safely increased beyond nine or ten times the cash reserve, any change in the cash reserve is reflected in the volume of deposits. Because of the relationship which exists between the quantity of money in circulation and prices, an increase in bank reserves is accompanied by a tendency to raise prices, and vice versa.

The Bank Act, 1934, provides for the keeping of a reserve in the form of a deposit with the Bank of Canada and of Bank of Canada notes of not less than five per cent. of a chartered bank's deposit liabilities within Canada.

**The Bank of Canada.** An act to incorporate the Bank of Canada was assented to on July 3, 1934. It provides for the establishment of a central bank in Canada. The purpose of a central bank is outlined in the preamble of the Act, which states that "it is desirable to establish a central bank in Canada to

regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion."

The Bank of Canada is managed by a Board of Directors composed of a Governor, a Deputy-Governor and seven directors. Ottawa is the seat of the bank's head office. The capital of the bank is fixed for the time being at \$5,000,000 in shares of \$50 each. Dividends are limited to  $4\frac{1}{2}$  per cent., but are cumulative and no person may own more than fifty shares of the capital stock of the bank.

**Functions of a Central Bank.** The chief function of a central bank is to regulate the volume of note issue and of bank deposits. To fulfil this function it must assume secondary functions which enable it to control money and credit more readily. (1) The central bank issues notes. (2) It holds the reserves of the other banks. (3) It conducts open market operations. (4) It rediscounts short term credit instruments. (5) It holds the government's bank account. (6) It is a depository for the central gold reserve. (7) It serves as a clearing house for the other banks. These functions are carried out by the exercise of the powers conferred upon the central bank by law.

**Powers of the Bank of Canada.** (1) The Bank of Canada may buy and sell coin and bullion, foreign exchange and securities. (2) It may buy, sell or rediscount bills of exchange and promissory notes endorsed by a chartered bank. (3) It may make loans and advances to chartered banks, savings banks, the Dominion and provincial governments. (4) It is empowered, for the purpose of its open market operations, to buy and sell in the open market from or to any person, securities, cable transfers, bankers' acceptances and bills of exchange. (5) The Bank of Canada is authorized to accept deposits of the Dominion Government or of the government of any province or of any

chartered or savings bank. (6) The power is also conferred on the bank to open accounts in other central banks or in the Bank for International Settlements and to receive deposits from them. (7) The bank has the sole right of note issue except that chartered banks may continue to circulate their notes with certain limitations. (8) The bank becomes the fiscal agent for the Dominion Government and for any provincial government which shall agree to have the Bank of Canada act as fiscal agent.

**Open Market and Rediscount Operations.** According to the quantity theory of money, when there is an excess of money in circulation, prices rise, and when there is a lack of money in circulation, prices fall. Money in circulation may be increased by the issue of additional notes or by the creation of fresh deposits; it may be decreased by restricting the note issue and by contracting deposits. The central bank can increase the amount of money in circulation by buying in the open market securities which are paid for with central bank notes or by giving a credit to the purchaser at the central bank; it can decrease money in circulation by selling in the open market securities which are paid for by the purchasers with central bank notes or by using a part of the purchaser's deposit with the central bank.

Rediscounting consists in discounting for other banks commercial paper which has already been discounted by the other banks. This process increases the quantity of money in circulation by placing new money at the disposal of the banks which exercise the privilege of rediscounting paper at the central bank. The quantity of such paper which is rediscounted is controlled by adjusting the rediscount rate. If the rate of rediscount is low, the commercial banks will tend to exercise this privilege more readily than they would if the rate were high. Hence, by means of open market operations or changes in the rediscount rate, the Central Bank is enabled to influence the price level.

It becomes desirable to raise the rediscount rate or to sell securities in the open market when prices are rising and to lower the rediscount rate and to buy securities in the open

market when prices are falling. However, the desired effect is not always obtained. If there is debt liquidation going on at a faster rate than the Central Bank is providing for the creation of new credit the efforts of the Central Bank are nullified.

**The Bank for International Settlements.** This bank was established in May, 1930. Its purpose according to its statutes is "to promote the co-operation of Central Banks and to provide additional facilities for international financial operations; and to act as trustee or agent in regard to international financial settlement entrusted to it under agreements with the parties concerned." The office of the Bank for International Settlements is located at Basle, Switzerland.

#### EXERCISES AND PROBLEMS

1. What is savings banking?
2. What is commercial banking?
3. Write out a bank deposit slip.
4. Why can deposits be used as a medium of exchange?
5. What is bank discount?
6. State the factors which affect the volume of deposits.
7. What are assets?
8. What are liabilities?
9. Collect five bank statements from your newspaper.
10. What are *Les Caisses Populaires*?
11. How many chartered banks are there in Canada? Name them.
12. How did the clearing house method of settling claims between banks originate?
13. Write a clearing house statement showing the settlement of claims between five banks.
14. What is the bank's reserve?
15. When was the Bank of Canada incorporated?
16. State the functions of a central bank.
17. What are the powers of the Bank of Canada?
18. What are open market operations?
19. What is rediscounting?
20. What are the effects of open market operations and of rediscounting on the price level?
21. Do changes in the price level always follow action for that purpose on the part of the central bank?
22. Keep a record of the rediscount rate and compare any changes with the index of wholesale prices.

## CHAPTER XII

# DISTRIBUTION

**Definition.** Distribution, in economics, is not the moving of goods from the producer to the consumer. Distribution is the sharing of the social income, the total returns of the productive units in the economic system. This social income must be divided among the individuals who have supplied the various factors of production: labourers, the owners of land and capital, the enterprisers who have borne the risks of production, and the government. Under a system based upon the division of labour, these shares cannot be taken in kind, that is, in goods and services. They are received as money by those who participate in the work of production. The spending of money is the means of obtaining one's share of goods and services. We are concerned here with the study of the money income received by labour (wages), by the owners of land (rent), by the owners of capital (interest), by the government (taxes), by the enterprisers (profit). The study of distribution, then, deals with wages, rent, interest, taxes and profit.

**Money Income.** Money income, or nominal income, is the amount of money received at intervals over a period of time, such as \$20 a week. Real income consists of the goods and services that satisfy man's wants. Real income changes with money income and prices. Rising prices mean a decreasing real income. Falling prices mean an increasing real income. Real income is sometimes obtained without first earning a money income. The farmer who uses produce from his farm obtains a real income which has nothing to do with his money income. The relationships between money income, real income and prices are important in the study of distribution.

**National Income.** The survey of production conducted by the Dominion Bureau of Statistics shows that the net value

of commodities produced by 2,453,877 gainfully occupied persons was \$3,217,000,000 in 1930. By assuming that 1,470,597 other gainfully occupied persons not included in the survey were equally productive, the Bureau arrives at an estimate of \$5,150,000,000 as the net value of Canadian production in 1930. The national income, which is equal to the net value of production, less capital replacements and new capital, was estimated as being 92 per cent. of the net value of production, or approximately \$4,750,000,000.

**Distribution of Income.** The figures of assessed income compiled by the Income Tax Branch of the Department of National Revenue serve as guides to the distribution of income. The following table shows the number of individual taxpayers by size of income:

TABLE 17

NUMBER OF INDIVIDUAL TAXPAYERS BY SIZE OF INCOME  
TAXED UNDER THE INCOME WAR TAX ACT,  
FISCAL YEARS ENDED MARCH 31, 1929-1933

Income Class	1929	1930	1931	1932	1933
Under \$2,000.....	36,857	38,709	38,788	37,002	63,276
\$2,000 to \$3,000.....	22,374	20,090	20,885	19,595	29,156
\$3,000 to \$4,000.....	19,408	24,429	22,869	21,160	27,546
\$4,000 to \$5,000.....	15,049	17,468	17,909	16,555	15,760
\$5,000 to \$6,000.....	9,529	10,980	11,348	10,410	8,951
\$6,000 to \$7,000.....	6,833	7,349	7,483	6,839	5,556
\$7,000 to \$8,000.....	3,950	4,620	4,814	4,573	3,481
\$8,000 to \$9,000.....	2,785	3,313	3,449	3,238	2,580
\$9,000 to \$10,000.....	2,185	2,607	2,609	2,462	1,962
\$10,000 to \$15,000.....	5,520	6,575	6,825	5,901	4,577
\$15,000 to \$20,000.....	2,197	2,540	2,878	2,405	1,653
\$20,000 to \$25,000.....	1,027	1,181	1,314	1,123	872
\$25,000 to \$30,000.....	579	674	784	646	483
\$30,000 to \$35,000.....				491	333
\$35,000 to \$40,000.....	{ 847	1,016	1,045	{ 267	169
\$40,000 to \$45,000.....					
\$45,000 to \$50,000.....				197	130
\$50,000 and over.....	523	603	601	143	97
Totals.....	129,663	142,154	143,601	133,621	166,972

**The Marginal Productivity Theory of Distribution.** The principles of diminishing returns and proportionality lead us to expect that the factors of production may be combined in several ways, each of which will produce different net returns.

The various productive units in the economic system produce goods under varying conditions of productivity. Those enterprises which enjoy the right combinations of good land, labour and capital are highly productive. At the other end of the scale we find business enterprises with wrong combinations of poor land, labour and capital; these enterprises, which are barely able to maintain an existence, are called the marginal enterprises. Their gross returns are just about equal to their costs. As long as their output is bought at prices which cover their cost of production, they stay in business. When other enterprisers increase their output and thereby increase the supply on the market, prices come down. Then the marginal enterpriser must cut his cost of production or be forced out of business. Provided there is a demand in the market which is sufficient to keep prices up at a level high enough to enable the marginal producer to cover his costs, he will stay in business. His output is needed. Consumers are willing to pay for that particular good a price that will cover the marginal producer's high costs. From the law of single price which states that there can be only one price in a given market for a given commodity at a given time, it follows that the most efficient producers receive as much for the goods they produce as does the marginal producer. On the other hand, they do not have to pay more for land, labour and capital than the marginal producer is paying. Efficient producers consequently enjoy relatively high prices, low costs and large net returns. Net returns are gradually scaled down from the maximum obtained by the most efficient producer to zero in the case of the marginal producer. The productivity of the marginal enterprise determines the shares of all the enterprises in the system.

**The Marginal Product.** Production in a given line will expand in volume only to the point beyond which further increase in production is not profitable. The yield from an acre of land will be increased only if the additional bushels produced will pay their cost of production. A farmer will hire extra labour only if the increased output will pay the increased cost.

When the cost of the product exceeds its price, production stops. As long as the price of the product exceeds its cost, production expands. The last unit produced, the one which barely pays its cost, is the marginal product. To get this marginal product more labour may have been added. The additional workman will therefore receive wages equal to the value of the marginal product which would not have been produced if he had not been added to the labour force. If new land is added the rent paid for the new land will tend to be equal to the price of the marginal product. If new capital is added the interest paid plus the depreciation and upkeep charged against it will likely approximate the price of the marginal product. The price of any factor of production tends to equal the price of the entire supply of that factor.

Caution must be used in applying these principles. They are not rigid laws which apply uniformly in all cases. At best, they are only broad tendencies modified by custom, monopoly, anticipation of profits and many other factors.

**The Substitution of Factors.** The price paid for the use of land is not settled without consideration of the price paid for capital and labour. A manufacturer has to choose between hiring more men or installing labour-saving machinery. If a farmer decides to cultivate intensively instead of cultivating extensively, he may use less land and employ more labour and capital. A farmer who has an extra \$1,000 to invest may buy more land or more capital or hire more labour. In any event he will spend his money for that factor which in his estimation will bring the largest returns. As the various enterprisers attempt to place their enterprises on a proportionality basis they are compelled to choose among the three factors of production. This has a tendency to keep the price paid for the different factors in close relation to the returns obtained from the different factors.

#### EXERCISES AND PROBLEMS

1. What is distribution?
2. What is social income?
3. Show why shares of the social income cannot be taken in kind.

4. A person has an income of \$10,000 consisting of:
- |  |          |
|--|----------|
| (a) Salary.....                          | \$5,000. |
| (b) Dividends on stocks.....             | \$2,000. |
| (c) Interest on bonds and mortgages..... | \$2,000. |
| (d) Rent of a store he owns.....         | \$1,000. |
- What part of this person's income should be called wages, what part profits, what part interest and what part rent?
5. What is money income?
6. What is real income?
7. Show how changes in money income affect real income. Give examples.
8. Show how changes in prices affect real income.
9. What was the per capita income in Canada in 1930?
10. In what income brackets do we find the largest group of income taxpayers?
11. Draw a bar graph showing the distribution of income taxpayers according to size of income.
12. How do you account for the wide differences in productivity among the various enterprises in the economic system?
13. What is a marginal farm? A marginal mine? A marginal store? A marginal enterprise?
14. Unless the enterpriser is a monopolist, who determines prices?
15. What becomes of an enterprise which cannot cover production costs?
16. What is the marginal product?
17. Under what conditions will a farmer hire extra labour?
18. A finds that he can produce a certain article more cheaply than other enterprisers. The market will take 100,000 units altogether. A produces 50,000 units. What will become of the enterprise which was marginal in this branch of production before A entered the field? Why?
19. What principles guide the enterpriser in the substitution of factors?
20. Discuss the substitution of factors and technological unemployment.

## CHAPTER XIII

### PRINCIPLES OF LAND RETURNS

**Rent.** The share of the aggregate income which is paid for the use of land is called rent. Land, it must be recalled, includes all natural resources. Economic rent differs from commercial rent. The rent paid for a house, for office space or for a car is an example of commercial rent. Commercial rent includes interest on capital as well as economic rent. Viewed from the basis of costs, economic rent is an element in the cost of any commodity.

Cost of commodity = economic rent and wages and interest. Hence, economic rent = cost of commodity — (wages and interest).

**The Size of Rent.** Production stops when costs exceed the selling price of the product. If the yield of a given tract of land is so low that the selling price of the product is just equal to the price paid for labour and capital, there is nothing left to be paid as rent. Such land is called no-rent land. Land of greater productivity would give a yield sufficiently large to meet wages and interest and to leave a surplus. This surplus resulting from the greater fertility of land is economic rent. Economic rent will therefore be equal to that part of the selling price of the product which is the result of the productivity of land. Hence, economic rent is due to differences in the productivity of land. The economic rent of farm land is due to differences in the fertility of the soil and distance from the market. The economic rent of city property is due to differences in location. The economic rent of mines depends on differences in the cost of mining because of the depth, the grade of the ore and the accessibility of the mine. The largest gold-producing mine in the world, in South Africa, was rapidly becoming a no-rent mine because of the increasing heat at increasing depths. Refrigeration is extending the life of the mine. The economic

rent of timber stands is due to differences in the size and quality of trees and accessibility to market. Because economic rent is the result of differences in productivity, it is also called differential rent.

**Economic Rent from Agricultural Land.** Consider, for example, four sugar beet fields of ten acres each. Labour and capital costs are assumed to have been the same in each case:

Soil preparation.....	\$40.00
Seeding.....	10.00
Seed.....	22.50
Fertilizer.....	57.50
Thinning and hoeing.....	60.00
Cultivation.....	40.00
Harvesting.....	50.00
Total labour and capital costs.....	\$280.00

Since there are differences in soil fertility, the first field yields 40 tons of beets, the second 50 tons, the third 60 tons, and the fourth 70 tons. Assuming that the sugar content is the same in each case, each farmer receives the same price per ton, say \$7.

The first grower, who has spent \$280 for labour and capital, receives \$280. He just breaks even. He gets no economic rent. His land, therefore, is no-rent land.

The second grower, having spent \$280, receives \$350. He pays his labour and capital costs and he has \$70 left over. This surplus is economic rent, a consequence of the greater fertility of his land.

The third grower spends \$280 and receives \$420. The \$140 surplus is also economic rent, created by the greater fertility of his land.

The fourth spends \$280 and receives \$490. His economic rent is \$210.

Accessibility, or proximity to market, is also a factor which affects economic rent. Suppose it costs the first grower 50 cents a ton to haul his beets, the second 60 cents, the third 70 cents and the fourth 80 cents. The first grower will be out of pocket. He will spend \$20 more than his gross returns. The second grower will spend \$30. His economic rent is therefore \$70 — \$30, or \$40. The third grower spends \$42. His economic

rent is therefore \$140 — \$42, or \$98. The last grower spends \$56. His economic rent is, therefore, \$210 — \$56, or \$154.

**Economic Rent in Mining.** Assuming that the labour and capital costs of mining and refining a ton of gold-bearing ore are the same for four different mines, and that the value of the gold content per ton is \$7, \$8, \$9 and \$10 respectively, we have the following differences in net returns which are exclusively due to differences in the quality and accessibility of the ore in the different mines.

	I	II	III	IV
Gold content per ton.....	162.54 gr.	185.76 gr.	208.98 gr.	232.20 gr.
Value of ore per ton at \$20.67 per oz.....	\$7.00	\$8.00	\$9.00	\$10.00
Capital and labour costs.....	7.00	7.00	7.00	7.00
Economic rent.....	0	\$1.00	\$2.00	\$3.00

In the above calculation it is assumed that the price of gold is \$20.67 per fine ounce. The recent rise in the price of gold to the neighbourhood of \$35.00 would, of course, raise the economic rent as follows:

	I	II	III	IV
Gold content per ton.....	162.54 gr.	185.76 gr.	208.98 gr.	232.20 gr.
Value of ore per ton at \$35.00 per oz.....	\$11.85	\$13.54	\$15.23	\$16.93
Capital and labour costs.....	7.00	7.00	7.00	7.00
Economic rent.....	\$4.85	\$6.54	\$8.23	\$9.93

The practical effect on the gold-mining industry of the increase in the price of gold is to bring the no-rent mines into the rent-earning group. These mines will earn an economic rent as long as costs do not rise proportionately with the price of gold. It may happen that mining costs will increase considerably if inflation follows the change in the price of gold. In that event certain mines will be crowded back beyond the margin of productivity into the no-rent group. Many new mines with low grade ore will be closed as soon as rising costs catch up with them and wipe out their economic rent. The first mine in the above group will be operated only as long as

capital and labour costs per ton of ore extracted do not increase up to or beyond \$11.85 per ton. When that level of costs is reached this mine will have to be closed. All other mines with ore of the same gold content, or with a lower gold content, and with the same labour and capital costs, will also have to be closed.

**Economic Rent and Urban Sites.** Economic rent derived from city lots is due to differences in location. Take for instance, four stores in a small grocery chain with the same equipment, the same stock and managed on the same basis. Let us assume that the stock in each store is worth \$10,000 and that the gross returns on each turnover is 20 per cent. By turnover is meant the number of times the stock is sold in a year. In this case there is a turnover every time sales amount to \$10,000. If the yearly sales are \$40,000 the turnover numbers four.

	I	II	III	IV
Turnover.....	1	2	3	4
Rate of returns.....	20%	20%	20%	20%
Sales.....	\$10,000	\$20,000	\$30,000	\$40,000
Gross returns.....	2,000	4,000	6,000	8,000
Capital and labour costs.....	2,000	2,500	3,500	4,500
Economic Rent.....	0	1,500	2,500	3,500

Store I is in a poor location and yields no economic rent. Situated more favourably stores II, III, and IV have more sales. Hence, superior location, by affecting the volume of sales, yields economic rent.

**The Margin of Substitution.** It is clear that a piece of land may be put to various uses. Land will have a tendency to be used for the purpose which will bring the largest net returns. In the vicinity of most large cities there is a region of truck farms. Some of these truck farms which are not profitable might earn an income if they were converted into field crop farms. They are at the margin of substitution. Further down the scale we find marginal wheat farms which might earn an income if they were converted into forest lands. On the other hand some of the truck farms mentioned above yield a large

economic rent. Yet if a greater economic rent can be earned by converting them into home building or industrial sites, the change will take place. Substitution of one use for another takes place at the margin of productivity. The tendency to substitute one use for another to get the largest possible net returns from land, is called the principle of substitution.

The application of this principle has broad social significance. The transfer of farm land from intensive cultivation to extensive cultivation is followed by a shift in the population from the country to the city.

#### EXERCISES AND PROBLEMS

1. What is economic rent?
2. What is commercial rent?
3. When commercial rent is higher than economic rent are farmers working rented farms meeting their production costs?
4. What is no-rent land?
5. Does economic rent affect the price the farmer receives for produce?
6. Give an example showing the influence of productivity of land and of accessibility to market on the size of rent.
7. Why is economic rent sometimes called differential rent?
8. Illustrate agricultural economic rent with an example of your own.
9. What factor determines urban economic rent? Give suitable examples.
10. The neighbourhood retailer maintains that his prices are low because his rent is low. If low rent is responsible for low prices explain why five and ten-cent stores are located on the highest rent sites in the city.
11. Ricardo wrote: "Corn is not high because a rent is paid, but a rent is paid because corn is high." Is this statement true or false? Why or why not?
12. The economic rent of a certain farm located within the limits of a large city is practically nothing, but its value is more than \$100,000. What is the reason for this high valuation?
13. State the factors affecting the size of economic rent of each of the following.
  - (1) A mine on the shore of Great Bear Lake.
  - (2) A natural gas well in Alberta.
  - (3) An orchard in the Okanagan Valley.
  - (4) A commercial airport near the city of Winnipeg.
14. A builds an apartment house after making a survey to find a paying location. He is successful in renting all his available space and his economic rent is high. B decides to build an equally large apartment house on the next lot. He builds only on the strength of the fact that A's apartments rent well. Half of A's tenants move into B's apartments and no new tenants move into the district.
  - (1) What happens to A's economic rent?
  - (2) If A's economic rent is wiped out, on whom would you fix responsibility?
  - (3) Does B receive any economic rent?
  - (4) What form of control would you suggest to curb enterprisers such as B, who not only lose their own funds, but who also destroy the value of other enterprisers' investments through lack of foresight?

## CHAPTER XIV

### WAGES

**Definition.** We are again reminded that the scientific meaning of a word often differs from the popular sense. The word wages is an example. As a rule, wages mean daily or weekly income received for labour, such as, \$5 a day earned by a factory operative, \$20 a week earned by a clerk. In economics wages include income received for labour of any kind, such as salaries paid to executives, fees paid to lawyers, commissions paid to salesmen, honoraria paid to doctors.

**Methods of Paying Wages.** Custom has left us several ways of paying wages. The most common method is the payment of a time wage. Piece work wages, commissions, fees, wages in kind and bonuses are other common methods.

1. Time wages are determined by the length of time the labourer has worked. When the rate is \$3 a day the labourer who is paid on a weekly basis after 5 days' work will find \$15 in his pay envelope. Quite often the time spent at work is the only available measure of wages because it is often impossible when many persons are employed on the same job to gauge the share which each workman has contributed.

2. Piece work wages are based on the number of operations performed. A punch press operator is paid according to the number of units of product he turns out. A berry picker is paid according to the number of quarts he picks. The great advantage of the piece work method is the elimination of loafing on the job; the chief disadvantage is that this method very often leads to overwork.

3. Commissions are paid as a percentage of the value of the business transacted. A real estate agent who is paid a 10 per cent. commission receives \$100 when he sells a \$1,000 lot. If the lot is sold on a deferred payment plan he may receive 25

per cent. of the down payment and a smaller percentage of the other payments as they are paid.

4. Fees and honoraria are equivalent to piece work wages. The difference lies in the fact that the product is a service instead of a commodity. Professional men are paid fees for their consultations and other services. These fees are often based on capacity to pay.

5. Wages in kind are usually paid to farm hands and domestic servants in addition to time wages. Wages in kind often consist of board and room.

6. Bonuses or extra wages are paid to employees who have rendered meritorious services. These may consist of gifts, additional payments, shares of stock in the business or group insurance policies.

7. Profit sharing plans have been introduced by certain successful firms. In addition to regular wages the employees are paid from the profits of the company much in the same way as stockholders are paid dividends.

**Wages and the Cost of Living.** To what extent can the individual satisfy his wants with a given money income? This question is best answered by going back to the distinction between money income and real income. Real income changes with prices. In other words, real income changes with the cost of living. A rising cost of living means a declining real income, provided money income remains the same; a drop in the cost of living means an increase in real income, provided money income remains the same. The following tables give index numbers of wages and of the cost of living. By comparing the two tables we can tell whether real wages are increasing or decreasing.

**The Importance of the Wage Level.** The level of wages paid is of great importance to industry. Nearly all money paid out in wages returns immediately to the enterprisers as the sales returns of their output. A relatively small part of the income of wage-earners is saved. Wages in the hands of consumers form a great reservoir of purchasing power from which are drawn the receipts of enterprisers. If this reservoir is not properly replen-

TABLE 18

## INDEX NUMBERS OF RATES OF WAGES FOR VARIOUS CLASSES OF LABOUR IN CANADA 1901-1932

Years	Average	Building Trades	Metal Trades	Printing Trades	Steam Railways	Coal Mining	Factory Labour	Logging and Saw-milling
1901.....	67.4	60.3	68.6	60.0	68.8	82.8	—	—
1902.....	70.0	64.2	70.2	61.6	72.0	83.8	—	—
1903.....	72.5	67.4	73.3	62.6	75.1	85.3	—	—
1904.....	74.5	69.7	75.9	66.1	76.9	85.1	—	—
1905.....	75.7	73.0	78.6	68.5	74.5	86.3	—	—
1906.....	78.6	76.9	79.8	72.2	79.3	87.4	—	—
1907.....	82.8	80.2	82.4	78.4	81.0	93.6	—	—
1908.....	84.9	81.5	84.7	80.5	86.1	94.8	—	—
1909.....	85.9	83.1	86.2	83.4	86.3	95.1	—	—
1910.....	88.9	86.9	88.8	87.8	90.1	94.2	—	—
1911.....	92.3	90.2	91.0	91.6	95.7	97.5	94.9	93.3
1912.....	96.0	96.0	95.3	96.0	97.9	98.3	98.1	98.8
1913.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1914.....	101.3	100.8	100.5	102.4	101.4	101.9	101.0	94.7
1915.....	101.4	101.5	101.5	103.6	101.7	102.3	101.0	89.1
1916.....	105.8	102.4	106.9	105.8	105.9	111.7	110.4	109.5
1917.....	119.9	109.9	128.0	111.3	124.6	130.8	129.2	130.2
1918.....	143.6	125.9	155.2	123.7	158.0	157.8	152.3	150.5
1919.....	165.3	148.2	180.1	145.9	183.9	170.5	180.2	169.8
1920.....	197.8	180.9	209.4	184.0	221.0	197.7	215.3	202.7
1921.....	191.2	170.5	186.8	193.3	195.9	208.3	190.6	152.6
1922.....	182.4	162.5	173.7	192.3	184.4	197.8	183.0	158.7
1923.....	183.3	166.4	174.0	188.9	186.4	197.8	181.7	170.4
1924.....	183.7	169.7	175.5	191.9	186.4	192.4	183.2	183.1
1925.....	179.7	170.4	175.4	192.8	186.4	167.6	186.3	178.7
1926.....	180.5	172.1	177.4	193.3	186.4	167.4	187.3	180.8
1927.....	184.3	179.3	178.1	195.0	198.4	167.9	187.7	182.8
1928.....	187.6	185.6	180.1	198.3	198.4	168.9	187.1	184.3
1929.....	192.7	197.5	184.6	202.3	204.3	168.9	187.8	185.6
1930.....	194.4	203.2	186.6	203.3	204.3	169.4	188.2	183.9
1931.....	190.8	195.7	182.9	205.1	199.2	169.4	183.4	163.0
1932.....	179.3	178.2	174.7	194.2	183.9	164.0	173.6	141.3

ished by the payment of sufficient wages, some enterprisers fail to sell their goods. It is, therefore, in the interest of all enterprisers that enough purchasing power should be placed in the hands of the consumers to enable them to buy back the output of industry. There is always a great deal of arguing over what constitutes a fair wage. There is seldom any concern about what constitutes that level of wages which will clear the market to enable production to continue. Custom has moulded in the thought of the people the opinion that \$5 a day is too much or that a wage of \$10 a day would be extravagant. From

TABLE 19

## TOTAL AMOUNT PER WEEK OF FAMILY BUDGET

Year	Jan.	Feb.	Mar.	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1919..	21.73	21.34	20.99	21.34	21.67	21.95	22.02	22.86	22.88	22.93	22.99	23.49
1920..	24.15	24.71	25.01	25.34	26.44	26.81	26.92	26.60	26.38	26.46	26.13	25.67
1921..	25.30	24.85	23.87	23.31	22.84	21.74	21.53	21.98	22.37	22.01	21.60	21.49
1922..	21.52	21.07	20.96	20.66	20.57	20.58	20.67	20.88	20.90	20.87	20.89	20.97
1923..	21.13	21.17	21.42	21.21	20.90	20.72	20.65	21.03	20.97	21.16	21.19	21.21
1924..	21.23	21.18	21.00	20.58	20.24	20.22	20.30	20.57	20.65	20.67	20.81	20.90
1925..	21.09	21.19	21.00	20.82	20.73	20.67	20.70	21.05	21.08	21.11	21.51	21.87
1926..	21.96	21.87	21.77	21.64	21.54	21.30	21.30	21.32	21.15	21.14	21.24	21.41
1927..	21.59	21.46	21.29	21.02	20.95	21.04	21.10	21.11	21.05	21.18	21.27	21.37
1928..	21.41	21.25	21.15	21.11	21.04	20.97	21.01	21.31	21.38	21.52	21.52	21.56
1929..	21.55	21.41	21.52	21.30	21.21	21.18	21.26	21.90	21.90	21.96	22.03	22.11
1930..	22.17	22.12	21.96	21.53	21.49	21.44	21.26	21.01	20.75	20.68	20.60	20.46
1931..	20.21	19.78	19.47	19.18	18.82	18.36	18.26	18.30	18.06	17.86	17.81	17.76
1932..	17.59	17.25	17.16	17.09	16.45	16.20	16.21	16.42	16.34	16.40	16.10	16.01
1933..	15.89	15.61	15.59	15.74	15.57	15.41	15.48	15.96	15.78	15.78	15.72	15.83
1934..	15.95	16.09	16.51	16.28	15.96	15.78	15.84	15.92	15.87	15.96	16.03	16.02

the scientific viewpoint it is obvious that the general wage level is too high only when it prevents the replacement of wear and tear in industry, the development of new capital and the shortening of working hours. To argue that wages should be high enough to preserve the standard of living, or to improve it, is like arguing that dynamos should be large to improve the brightness of our lighting systems rather than to effect economies in production which will insure a larger total output.

Since the price level determines the purchasing power of money wages it should always be kept in mind when discussing wage rates. Index numbers of wholesale prices, retail prices, cost of living and purchasing power provide ready means of ascertaining changes in the price level.

**Non-Competing Labour Groups.** The nation's labour force is made up of different groups of workers possessing unequal skill and receiving unequal remuneration. Each group is large or small according to the amount of skill or talent required to perform the work demanded. The largest group is that of the unskilled labourer; the smallest is that of the highly talented men who act as executives. In between the largest and the smallest groups we find a great number of intermediary groups.

The important thing to note about the division of the labour force into groups is the fact that workers in one group are not in competition with those of other groups. However, it is possible for an individual to change from one group to another. Many self-made men who have risen from the ranks are examples of individuals changing from one group to another. But the group from which they rose to eminence still remains. The reasons advanced for the existence of such groups are interesting.

1. Heredity affects the ability of the individual. Certain families possess traits or characteristics which make them more vigorous and more self-reliant. These are transmitted from one generation to the next. Intelligence also is transmitted from parent to offspring. A study of the ancestors of great men has often shown that one or more of their forebears had unusual qualities inherited by their descendants. The scientific difficulty in this explanation lies in our ignorance of the number of generations required to extinguish a given trait, good or bad. Then, if the influence of a person's ancestry comes from very far back, which among thousands of ancestors were responsible for his position in life? A study of the following table will reveal the number of ancestors we have at each generation, provided there is no intermarriage.

TABLE 20  
ANCESTRY TABLE

Number of past generations	Number of ancestors
1.....	2
2.....	4
3.....	8
4.....	16
5.....	32
6.....	64
7.....	128
8.....	256
9.....	512
10.....	1,024
11.....	2,048
12.....	4,096
13.....	8,192
14.....	16,384
15.....	32,768
16.....	65,536
17.....	131,072
18.....	262,144
19.....	524,288
20.....	1,048,576

2. Environment affects the development of abilities. Many novels written on changelings illustrate this point. The wealthy nobleman's son who is stolen from the cradle and exchanged for a rude peasant's child looks and acts like a peasant when brought up in a peasant environment. Meanwhile the peasant's son brought up in the refined atmosphere of a baronial mansion wins the favour of his king by the grace of his actions, the charm of his speech and the wit of his repartee. Compulsory education has a tendency to create a uniform learning environment for a large majority of the population, but the benefits of the school are often neutralized by home influences. Education has a great deal of importance in determining the position an individual will occupy in society. Poor home influences prevent many a normal child from acquiring an education that would fit him for a higher plane of work in life. Chief among the evil influences found in such homes are shiftlessness, dishonesty, intellectual and moral indifference, and lack of paternal authority. Other homes are known for their honesty, sincerity, thrift and ambition co-ordinated for the advancement of the members of the family under the authority of good parents.

**The Marginal Productivity Theory of Labour.** In each non-competing group of labourers there is a marginal labourer who increases production just enough to make it worth the enterpriser's while to hire him. The additional product resulting from his work is the marginal product. His wages tend to equal in price this marginal product. Now, the employer will not have to pay more for other employees of the same class than the marginal labourer receives in wages. Consequently, in each non-competing group the marginal labourer sets the wages of the whole group.

**Other Theories of Wages.** The difficulties encountered in finding a general law to explain the wage level are reflected in the number of theories of wages. The following are those which have figured most prominently among the various explanations advanced.

1. The wages-fund theory. It is stated, as follows by J. R.

McCulloch in his *Principles of Political Economy*. "The amount of subsistence falling to each labourer, or the rate of wages, must depend on the proportion which the whole capital bears to the whole labouring population. If the amount of capital were increased, without a corresponding increase taking place in the population, each individual would get a larger share, or the rate of wages would be augmented. And if, on the other hand, population were increased faster than capital, a less share would be apportioned to each individual, or the rate of wages would be reduced."

2. The Iron Law of Wages. This theory was first called the cost-of-production theory. According to this wage theory labour is paid only as much as it costs to bring up a new supply of labour to replace that part of the working population which dies, or which becomes unfit to work. The Socialists accepted the cost-of-production theory as true and called it the Iron Law of Wages. In fact, they argued, as soon as the population increases wages must fall. They preached the doctrine that labour would be held down by this inevitable Iron Law until Socialism came into its own. Lassalle, a German Socialist, first used the term Iron Law of Wages.

3. The standard of living theory of wages. According to some economists, the standard of living has everything to do in the determination of wages. Wages, according to this theory, are just high enough to maintain the standard of living.

4. The residual theory of wages. Francis A. Walker, an American economist, brought out this theory in 1876. Walker was one of the most bitter opponents of the wages-fund theory which still held sway at that time. He held that labour is "the residual claimant to the product of industry." Labour gets everything that is left over after rent, interest and profit have been deducted from the price of the product. This view is discredited to-day. Modern economists hold that the enterpriser is the residual claimant.

#### EXERCISES AND PROBLEMS

1. Define wages.
2. What are time wages?
3. How are piece work wages paid?

4. What are the advantages and the disadvantages of the piece work method of paying wages?
5. What are commissions?
6. A real estate agent sells a lot for \$1,500 on an instalment plan. The down payment is \$500. The balance is to be paid at the rate of \$10 per month. The agent receives one-half of the down payment and 10 per cent. of the monthly payments for three years. What is the rate of commission?
7. What are fees and honoraria?
8. What are wages in kind?
9. What are bonuses?
10. What are the advantages of the profit-sharing plan?
11. What are real wages?
12. Do you consider labour as a commodity? Why or why not?
13. What is a fair wage?
14. Why are wages often considered as customary prices?
15. What are non-competing labour groups?
16. What are the effects of heredity and environment on the existence of non-competing groups?
17. Explain the marginal productivity theory of labour.
18. What is the wages-fund theory?
19. What is the Iron Law of Wages?
20. Is labour the residual claimant in the sharing of social income?

## CHAPTER XV

### INTEREST AND PROFITS

**Interest.** That part of costs which is paid out for the use of capital is called interest. The term interest has too broad a meaning to be used in economics without some kind of accompanying word to make its meaning more accurate. Thus, we speak of both loan interest and imputed or implicit interest. The former is the amount paid by a debtor to his creditor for advances of goods, services or purchasing power. Imputed interest is, like rent and wages, a part of the selling proceeds of the goods produced by industry. It is the share which goes to capital, the third factor of production. Interest is expressed as a percentage of the amount of a loan or investment. The amount on which interest is paid is called the principal.

**Gross Interest and Net Interest.** We have seen that one of the essential elements of the use of credit is waiting for repayment of the loan. That part of interest which is paid for waiting is pure interest or net interest. Besides waiting for repayment, loan corporations and money-lenders have to manage their business. Loan management costs and pure interest added together make up gross interest. If a mortgage loan company borrows money by selling 4 per cent. debentures and lends money at 7 per cent. the difference of 3 per cent. represents management costs or service charges. Another element in gross interest is the reward to be received in return for risk-bearing. Lenders or investors face the possibility of losing their money. Investors will assume greater risks only at greater charges. Some personal loan corporations will lend \$100 without collateral, provided the borrower will pay back \$125 in ten monthly instalments. This is equivalent to a rate of  $66\frac{2}{3}$  per cent. per annum.

**The Rate of Interest.** There are at any given time several rates of interest, corresponding to short term investments, long

term investments, consumption loans and other forms of lending.

1. The short term rate or the bank rate is the average rate charged for short term loans which are usually granted by discounting short term paper.

2. The long term rate or the bond rate is the average rate charged for long term loans which are represented in the market by bonds and debentures.

3. The term market rate is sometimes used to mean the average of short term and long term rates.

The importance of the rate of interest cannot be overlooked. If, after drawing plans and calculating prospective profits, an enterpriser finds that, although the general rate of interest is 5 per cent., a certain enterprise will give net returns of only 4 per cent. on funds invested, he will abstain from launching the new enterprise, either because he can get more for his funds elsewhere or because he finds himself unable to borrow at 4 per cent. to start the new business. The value of real estate is deeply affected by the rate of interest. The value of land is the capitalization of its income at the general rate of interest.

These rates vary between the various kinds of loans and also from time to time. Several factors affect interest rates.

1. The supply of funds available for investment influences the rate of interest. In countries where savings are large the rate of interest is generally low. It must be noted here that the quantity of such funds is not altogether the result of the penny wisdom of the inhabitants of a given country. A substantial part of savings comes from corporations and wealthy individuals who reinvest the proceeds of their past investments.

2. The state of development of financial institutions in a country affects its rate of interest. Where banking policy is formulated by a central bank the rate of interest is adjusted more readily to economic conditions.

3. Business confidence is necessary if funds are to be brought into the investment market. Unbalanced government budgets, unwarranted taxation, danger of war or revolution, panics, industrial unrest and other disturbing factors precipitate hoard-

ing and flight of capital to foreign countries. When funds are scarce the rate of interest rises. However, the rate of interest is seldom allowed to go up in times of depression. It is kept at low levels by action on the part of central banks.

4. The rate of interest is generally higher in new countries than in old countries.

5. When savings exceed investments the rate of interest tends to fall, and when investments exceed savings the rate of interest tends to rise.

6. Custom tends to keep the rate of interest relatively stable. Investors who are accustomed to receiving returns of 5 per cent. will refrain from investing at 3 per cent. in the hope of seeing the rate of interest rise again; borrowers who are accustomed to paying 5 per cent. will refrain from borrowing at 7 per cent. in the hope of seeing the rate of interest fall again.

**Real Rates and Money Rates.** If prices fall during the period of a loan the borrower is called upon to pay back more purchasing power than he borrowed. If prices have moved upward he pays back less purchasing power. A person who borrows \$100 on January 1 at 5 per cent. is expected to pay back \$105 on January 1 next. If prices fall by  $33\frac{1}{3}$  per cent. in the meanwhile and the value of money consequently increases by 50 per cent. the borrower will be paying a real rate of over 50 per cent. per annum. In fact he will pay back \$105 plus 50 per cent. or the equivalent of \$157.50 in terms of the short dollars he borrowed.

**Interest Rates in Canada.** Interest rates have changed considerably in Canada over a period of years. To measure these changes the yields of Ontario Government bonds have been assembled from 1900 to the present day and converted into index numbers by the Dominion Bureau of Statistics. It will be recalled that the yield of a bond is the returns it will bring on an investment of \$100 at its market price. A 5 per cent. bond selling at 90 yields 5.55 per cent. per annum.

**Theories of Interest.** Various opinions have been advanced to explain the willingness of people to pay interest and why

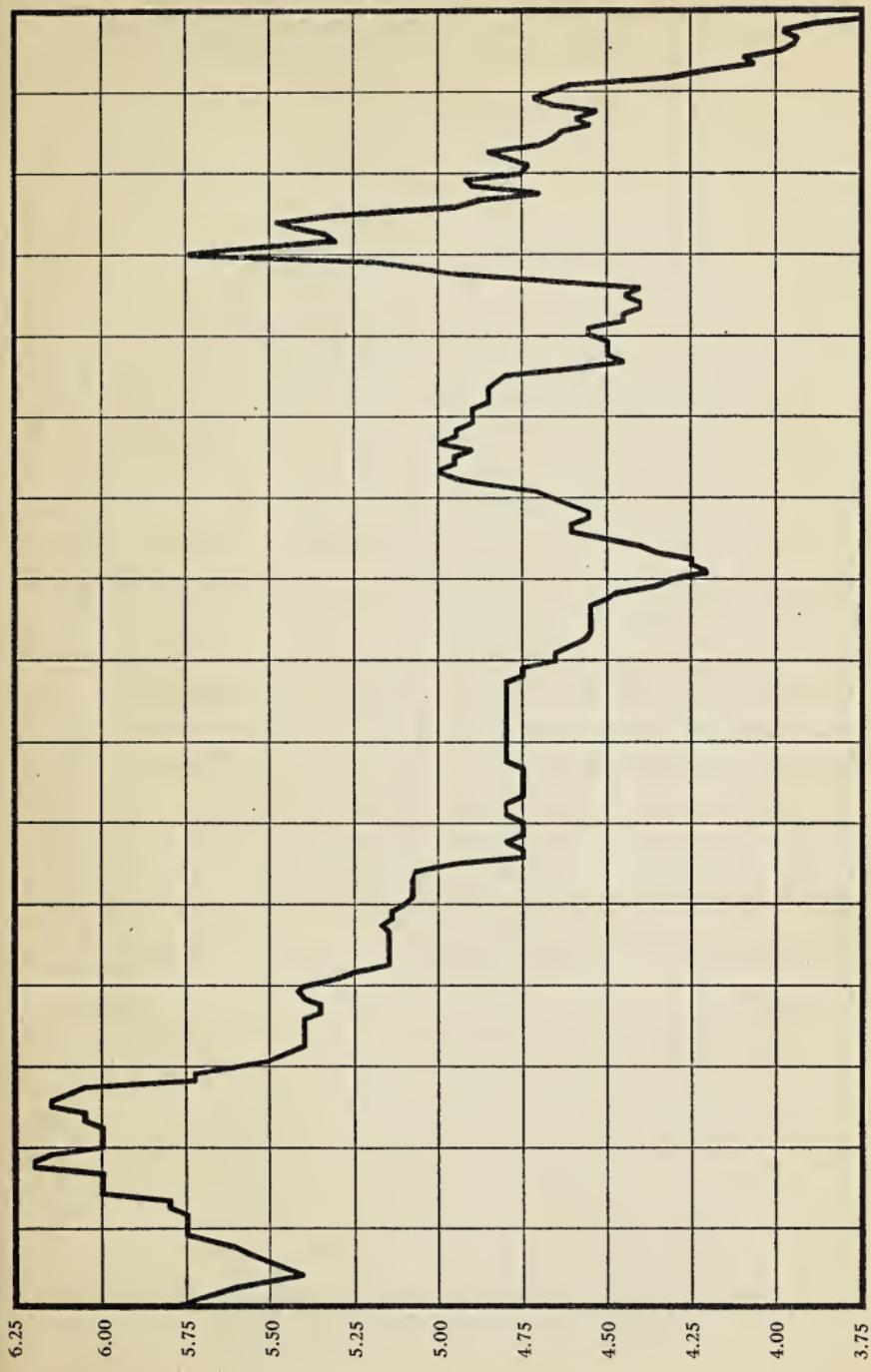


FIG. 20. ONTARIO GOVERNMENT BOND YIELDS

interest should be charged. Bohm-Bawerk, an Austrian professor, classifies several theories which he attempts to destroy for the purpose of justifying his own theory.

1. Productivity theories. These theories are statements of the supposed fact that interest is the reward of the productive services of capital.

2. Use theories. Interest is the price charged for the use of capital.

3. Abstinence theories. Some writers allege that interest is a reward for abstinence. Funds can be accumulated only by abstaining from consumption. This theory was ridiculed by Lassalle, who called the Rothschilds the chief abstainers of Europe.

4. Labour theories. According to these theories interest is a wage paid for the labour of the owners of capital.

5. Exploitation theories. These are socialist theories. According to many socialist theories, interest is due to the exploitation of labour which alone is productive of wealth.

6. The Austrian theory. According to Bohm-Bawerk, who has written extensively on the nature of interest, we pay interest because we value differently present goods and future goods. Because the promise of future payment is considered to be worth less than the immediate payment, promise of an additional payment is asked. This extra payment is interest. To understand why interest is charged, imagine someone asking you to choose between a five-dollar bank note for your birthday and a written promise to pay five dollars on your next birthday.

The promise to pay five dollars would not have the same value as actual cash. In the same way, in business, promises to pay money are not considered to be worth as much as the same amount in cash. To give the promise to pay the same value as cash, credit buyers or borrowers agree to repay more in the future than they get in the present.

**Profits.** In everyday speech we call profits the net earnings of a business enterprise. This is too broad a sense for our purpose. If the enterpriser owns the lands and the capital and also

does the work of the enterprise, it is clear that his net earnings include many things which we have previously called wages, rent and interest. Most farmers are in this position. To them profits mean income less outgo. To the economist profits mean income less outgo including all charges for management, labour, land and capital. Profit is the residue, what is left over for the enterpriser, after all the other shares have been accounted for. To distinguish between the common meaning of the word and the scientific meaning we sometimes use the terms gross profits to mean net returns, and pure profits to mean net returns minus the shares of the other factors of production.

**Pure Profit is a Differential Gain.** The marginal enterpriser barely breaks even. He has no profit and no loss. If he has a loss he is forced out of business unless he has previously built a reserve. The most successful enterpriser who manages to keep down costs and sells goods and services at prices obtained by marginal enterprisers enjoys a wide spread between total income and outgo. The intermediary enterprisers have smaller and smaller profits according to their position in the descending scale from the most successful producer down to the marginal producer. Consequently, pure profit, like rent, is a differential gain.

**Profits and the Price Level.** When the price level is lowered, the fall in costs has a tendency to lag behind the decrease in the selling proceeds. Fixed costs form a large percentage of industrial costs. Although variable costs may change as quickly as sale proceeds, fixed costs which are determined in many cases by long term contracts, such as bonds and leases, can be readjusted only with the greatest difficulty. Hence, when prices fall many enterprises are caught between the upper and nether millstones of fixed costs and decreasing selling proceeds. Deflation tends to turn profits into losses. Prolonged losses cause business failure. A rise in the price level has an opposite effect. When prices rise, selling proceeds increase and fixed costs remain at the old level. The result is a widening spread between sale proceeds and costs.

**Profits Regulate Industry.** In a Socialist system industry is planned. The demand for goods is estimated and production is scheduled accordingly. A central authority determines beforehand the number of miles of rail that will have to be laid, the number of millions of pairs of shoes that will be required, the number of acres that will have to be cropped and the number of mines that must be exploited. This plan is modified as new information is collected and production is intensified in certain lines at the expense of other lines of enterprise. In a capitalist system production is self-organized much according to the *laissez-faire* principle. Adam Smith in his *Wealth of Nations* stated that:

"Every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage, indeed, and not that of society, which he has in view. But the study of his own advantage, naturally, or, rather, necessarily, leads him to prefer that employment which is most advantageous to society. What is the species of domestic industry which his capital can employ, and of which the produce is likely to be of the greatest value, every individual, it is evident, can, in his local situation, judge much better than any statesman or lawgiver can for him."

There is in Canada relatively little government regulation of a type which tends to discourage enterprisers from entering certain lines of business. Enterprisers in Canada are free to choose that line of business which will bring the largest profits. Naturally, as the number of enterprisers increases in any line of business, the differential gain will decrease and no more new enterprisers will be drawn into this line. Since, in this way, profits affect the number of enterprisers engaging in any given line of economic activity, the need of a planning body to organize production is not felt except in times of business depression when readjustments take place on a large scale.

**Profits are Essential to the Development of New Enterprises.** John Maynard Keynes in his *Treatise on Money*, states that "the engine which drives enterprise is . . . profit." If

there are no anticipated profits, no new enterprises will be started. Booms and periods of prosperity occur only when the expected rewards of the captains of industry appear large and easy to get. Of course there is another important factor in the development of prosperity: thrift must accumulate the funds necessary for the new ventures. Yet, savings are useless without the spirit of adventure which is prompted forward by the prospects of gain. Thrift goes on in vain unless savings are put to profitable uses.

**Pure Profits and Losses Tend to Cancel Each Other.** There have been many discussions on the excessive profits of industry, but we hear very little of the losses of industry. It is a characteristic of human nature that men are prone to count the hits and disregard the misses. It is only the more careful reader who scans the batting averages where misses are taken into account. Few people stop to think that there are more misses than there are hits. The wreckage of business enterprises is strewn over the bankruptcy court records of all countries. It is generally agreed among economists that in the long run pure profits and losses equal each other and that net pure profits equal zero.

#### EXERCISES AND PROBLEMS

1. What is interest?
2. Define gross interest and net interest.
3. Why are there several different rates of interest?
4. What factors affect the rate of interest?
5. A person borrows \$100 for one year at 6 per cent. per annum. In the course of the year the price level falls by 20 per cent. What is the real rate of interest?
6. Name six theories of interest.
7. Describe the Austrian theory of interest.
8. What is the effect of the interest rate on the launching of new enterprises?
9. Define profits.
10. What are net returns?
11. What are pure profits?
12. Why is pure profit a differential gain?
13. What are the effects of rising prices on the level of profits?
14. What are the effects of falling prices on the level of profits?
15. How is industry planned in the U.S.S.R.?
16. Show how profits regulate the launching of new enterprises.
17. Why are profits essential to the development of new enterprises?
18. Construct a graph of business failures in Canada for the past ten years.  
(Consult the *Canada Year Book*.)
19. Why do pure profits equal zero in the long run?

## CHAPTER XVI

### INTERNATIONAL TRADE

**Definition.** No country is self-sufficient. A high standard of living may be maintained only in a country in which a wide variety of goods is consumed. Variety of products can be obtained only by trade with other countries. A country usually either has a surplus of some commodity to offer, or is in a position to give certain services of which other nations are in need. The exchange of goods and services among the countries of the world is called international trade.

**Comparative Advantage.** Cases of a commodity produced in only one country are rare. A country so favoured has an absolute advantage over all other countries. We are not concerned with such extreme cases, which are the exception rather than the rule. The common occurrence in international trade is that several countries enjoy a comparative advantage over other countries in the production of certain commodities. This comparative advantage arises from the fact that certain countries can produce goods at a lower cost, and place them on the market at a lower price than their competitors. They have special facilities which enable them to produce more cheaply.

1. Natural resources provide special facilities. Ore in the mines of one country may be more easily mined and refined than ore found in another country. Such products as coffee, tea, cocoa, and rubber grow only in a special climate. Soils differ in fertility, and crop yields are consequently higher in certain regions.

2. Human capacity is subject to wide differences. Scientific ability, skill in organization and production, vigour and enterprise may give advantages not enjoyed by nations not so well gifted. Industrial processes requiring great skill are undertaken only by peoples endowed with these essential qualities.

3. Unequal distribution of population gives rise to differences in production: Sparsely populated lands are often agricultural lands; densely peopled countries are often manufacturing countries. Countries which are essentially agricultural can produce farm products more cheaply than industrialized nations, while peoples who have a highly developed manufacturing system can produce finished products at a lower cost.

4. There is the legacy of the past. A nation's history may work for good or for evil on its present trading capacity. If a nation has an honourable record in the meeting of its obligations, in delivering products according to the standards of quality and performance claimed for them, and in practising fair play in all commercial transactions, the road to trade is smooth and easy to travel. The unfortunate nation which has sacrificed these advantages for immediate gain meets only failure.

A country may also possess the advantage of a great heritage of capital goods accumulated over many generations. Manufacturing plants, railways and a fleet of merchantmen, improved land and an accumulated store of knowledge constitute tremendous advantages in producing goods cheaply; these are advantages that may be overcome by less fortunate nations only with great difficulty.

We can conclude from the above that certain nations, being endowed with special advantages, may produce certain classes of goods at a lower cost. We thus arrive at the law of comparative advantage: A nation produces for export only those goods which it can produce at a lower cost of production; whereas it imports those goods which other nations can produce at a lower cost of production.

**Mutual Advantage.** If all nations produce only those goods for which they are best equipped to produce, the total production will necessarily be larger and there will be gains for all concerned. The international division of labour which allows each nation to specialize in the production of goods which it can produce most efficiently is possible only under certain conditions. At times some countries do not desire to become dependent on

other nations for important means of subsistence. At present, European countries are more anxious to produce their own wheat and increase their war potential than to further the specialization of Canada, Argentina and Australia in the production of this foodstuff. It is obvious that new countries with large tracts of undeveloped land can produce wheat more cheaply than old countries where every inch of land is at a premium. The statesmen who formulate national policy in countries which are subject to blockade are far-sighted enough to see the spectre of famine rising over a war-torn Europe. They simply have no choice when they are confronted with cheap food in the present, and famine in the future. Nations often have to overlook large immediate gains. The law of self-preservation imposes restrictions upon a great many of them.

In spite of necessary restrictive policy international trade has expanded to great proportions. This commerce brings mutual advantages because it raises standards of living by increasing the volume of world production.

**Pecuniary Advantage.** Exports of goods and services bring about an inflow of money, while imports of goods and services cause an outflow of money from any given country. If more money is paid out of a country than is paid in, the enterprisers will very likely find themselves with unsold stocks of goods. They will not take back as the selling proceeds of their products the money which they paid out, because that money has gone abroad.

If a cargo of cheap shoes is imported, the money that would have been spent on Canadian-made shoes goes abroad and Canadian shoe manufacturers are forced into difficulties. The nation as a whole may gain from the exchange of cheaply produced wheat for cheaply produced shoes. Neither the manufacturer who goes to the wall nor his employees are concerned with national gain. He is anxious to receive dollars from consumers to meet his cost of production. It therefore is apparent that national advantage may be definitely disadvantageous to an individual, or to a group of individuals within the country.

As a result of the working of this principle it is often proclaimed that the nation must export at all costs, while it must shun imports as far as it is practicable. Exports bring in dollars to enterprisers. Imports take dollars away from them. Since business is a struggle to get the purchasing power which the consumers spend, business men, as a rule, try to prevent the removal of purchasing power from circulation at their expense. They attempt to restrict imports and to increase exports to obtain a favourable balance of trade which means a surplus of exports over imports.

**Canada's Position in International Trade.** Canada as a trading nation occupies an important place among the principal countries of the world. In 1933 Canada held eleventh place in import trade, sixth place in export trade and ninth place in aggregate trade.

**Canada's Trade with Principal Countries.** Canada exports most to the United Kingdom and imports most from the United States. During the past few years the tendency of Canada's trade has been towards a greater exchange of commodities with Empire countries. This is chiefly the result of a wider application of the principle of British preference strengthened by the signing of trade agreements between the United Kingdom, the autonomous Dominions and the Crown Colonies. In 1933, the United States, the United Kingdom, Germany, France, Australia, British South Africa, British India, Japan, the Netherlands and Belgium, were, in that order of importance, the chief sources of our imports. In the same year the United Kingdom, the United States, the Netherlands, Belgium, France, Japan, Germany, China, St. Pierre and Miquelon, and Australia were, in the order named, the ten leading countries to which Canada sent exports.

**Canada's Leading Imports and Exports.** During the fiscal year 1933, the ten leading commodities imported into Canada were coal, crude petroleum, fruits, sugar and products, machinery, alcoholic beverages, rolling mill products, refined petroleum, cotton goods and automobile parts, in the order

named. Our ten leading exports were, in order of importance, wheat, newsprint paper, wood pulp, wheat flour, fish, planks and boards, raw furs, copper bars, whiskey and cheese.

**The Balance of International Payments.** Balance of trade means the difference between the value of commodity imports and the value of exports. When there is an excess of exports over imports, the balance of trade is said to be favourable; when there is an excess of imports over exports, it is said to be unfavourable. The term balance of trade refers only to the visible trade in commodities. It does not take into account a great number of invisible items, such as foreign investments, tourist expenditures, reparations and services rendered. The balance of international payments includes both visible and invisible items. The invisible items are classified as imports or exports, as if they were actual commodities. An invisible item is classified as an import when it is accompanied by a money payment out of the country; it is an export when it is accompanied by a money payment into the country.

The visible items are coin and bullion, and merchandise. The chief invisible items are freight payments, tourist expenditures, interest and dividend payments and receipts, immigrant remittances, government expenditures and receipts, reparations, charitable and missionary contributions, insurance transactions, advertising transactions, motion picture earnings, capital of immigrants and emigrants, and many kinds of services too numerous to classify.

1. *Visible Items.* (1) Coin and Bullion. When there is a shortage of Canadian funds abroad, those who wish to make payments in Canada use coin or bullion, usually gold; when there is a shortage of foreign funds in Canada, Canadians who want to make payments abroad also use coin and bullion. These shipments are practically never made by individuals. They go to a bank and buy drafts or they send cheques. The bank sends coin and bullion when it is the cheapest means of payment available to meet the claims which arise when such cheques and drafts are presented for payment. Coin and bullion sent out

of the country are exports; when brought into the country they are imports.

2. Merchandise shipped out of the country is an export; merchandise shipped into the country is an import.

2. *Invisible Items.* (1) Freight payments. When foreign freight is carried by Canadian railway or steamship companies, foreigners have to send funds into Canada; when Canadian freight is carried on foreign lines, Canadians have to send money abroad. Freight payments made by Canadians to foreigners are equivalent to imports; freight payments made by foreigners to Canadians are equivalent to exports.

TABLE 21

ESTIMATED BALANCE OF CANADA'S INTERNATIONAL PAYMENTS, 1932 AND 1933  
(Add 000)

Item	1932		1933*	
	Exports Visible and Invisible	Imports Visible and Invisible	Exports Visible and Invisible	Imports Visible and Invisible
	\$ 000	\$ 000	\$ 000	\$ 000
1. <i>Commodity Trade.</i> —(Corrected by deduction of non-commercial items, over valuations, etc.)				
Corrected total of commodity trade.....	496,275	416,566	535,000	389,250
2. Exports and imports of gold coin and bullion.....	60,825	2,175	66,000	850
3. Correction for gold movement on account of exchange premium on gold.....	7,919	—	27,000	350
4. Freight payments and receipts, n.o.p.....	38,864	58,864	40,000	55,000
5. Tourist expenditures.....	212,448	57,403	110,000	50,000
6. Interest payments and receipts.....	56,000	248,000	50,000	275,000
7. Immigrant remittances.....	6,080	7,127	5,000	6,000
8. Government expenditures and receipts.....	8,850	10,379	6,500	9,500
9. Charitable and missionary contributions.....	500	1,000	1,000	1,000
10. Insurance transactions.....	24,000	17,000	15,000	11,000
11. Advertising transactions.....	2,000	3,500	1,500	3,000
12. Motion picture earnings.....	—	3,250	—	4,000
13. Capital of immigrants and emigrants.....	4,416	3,775	4,000	3,250
14. Earnings of Canadian residents employed in U.S.A. (net figure).....	750	—	700	—
15. Exchange London and New York on interest and maturity payments and receipts.....	10,000	23,750	3,000	12,000
16. Known omissions, such as direct magazine subscriptions, artists' and entertainers' receipts, radio programmes, etc.....	—	4,000	—	4,000
17. Difference between all exports and imports†.....	—	72,138	—	40,500
Totals.....	928,927	928,927	864,700	864,700

\*Preliminary figures.

†This item represents net capital movements and errors and omissions.

(2) Tourist expenditures. Each year many tourists come from the United States and from oversea countries to visit Canada. These welcome visitors spend rather freely. Canadians, too, go abroad and spend money. Tourist expenditures made by foreigners visiting Canada rank as exports; Canadian tourists' expenditures abroad rank as imports.

(3) Foreign investments. When a country has accumulated a large supply of capital, there is no great demand for savings and the rate of interest is low. In undeveloped countries where natural resources are abundant capital can be used more profitably. Savings invested in these countries yield higher returns. Investors in one country buy stocks and bonds in another country to get these higher returns. Foreign investment is the international buying and selling of securities. A resident of the United Kingdom who buys Dominion Government bonds lends his money to the Canadian Government. A Canadian who buys British Consols lends his money to the government of the United Kingdom. Investments made here by residents of other countries are exports; investments made abroad by Canadians are imports.

(4) Interest and dividend payments and receipts. When Canadians invest money abroad they draw interest or dividends from foreigners. These receipts are equivalent to exports. Canadians remit dividend and interest payments to foreign holders of Canadian securities. These payments are equivalent to imports.

(5) Immigrant remittances. Residents of Canada who have relatives in other countries make a practice of sending them part of their income. Many Canadians living in other countries send money into Canada. Money sent out of Canada by immigrants is classified as an import; money sent into Canada by Canadians living abroad is classified as an export.

(6) Insurance transactions. Canadian insurance companies do a considerable business in other countries, and many foreign companies have offices in Canada. When Canadians pay premiums to foreign companies the transaction is equivalent to an import because money leaves the country; when these com-

panies pay claims to Canadians the transaction amounts to an export because money is sent into Canada. When foreigners who pay premiums to Canadian companies send money to Canada, the transaction is equal to an export; when Canadian companies, in paying claims to foreigners, send money out of the country, the transaction is equal to an import.

The other items are classified into imports and exports according to the same principle. When money leaves the country, the transaction is equivalent to an import; when money comes into the country, the transaction is equivalent to an export.

#### EXERCISES AND PROBLEMS

1. What is international trade?
2. State the factors which give a country a comparative advantage over other countries.
3. State the law of comparative advantage.
4. Why does international trade work to the mutual advantage of trading countries?
5. What is meant by war potential?
6. State why national advantage may be disadvantageous to an individual or to a group of individuals within the country.
7. Why do business men attempt to increase exports and to limit imports?
8. What is Canada's position in international trade?
9. Name the principal countries to which Canada exports goods.
10. Name the principal countries from which Canada imports goods.
11. State in their order of importance last year's leading imports into and exports from Canada.
12. What is the balance of trade?
13. What is the balance of international payments?
14. What percentage of the export items in the balance of international payments for 1933 consisted of invisible items?
15. Name the visible items in the balance of international payments.
16. When is an invisible item classified as an import? As an export?
17. Assume that a sum of \$200 is spent in Canada by an American tourist.
  - (a) Is this a visible or an invisible item?
  - (b) Is it an import or an export in Canada's balance of international payments?
18. A Montreal book firm buys \$1,000 worth of books in Paris; a Canadian tourist spends the same amount of money in France. Would you expect the two items to cancel each other in our balance of international payments? Why or why not?
19. The Canadian Government borrows \$50,000,000 in New York and transfers the money to Canada.
  - (a) Is this an import or an export?
  - (b) What pecuniary advantage would this transfer give to Canadian enterprisers?
  - (c) Would you expect purchasing power in Canada to increase in quantity as a result of this transfer?
  - (d) If this were used as an expedient to bolster trade in Canada, would you recommend its frequent use? Why or why not?

## CHAPTER XVII

### FOREIGN EXCHANGE

**Definition.** Foreigners must send Canadian money to Canada to pay for Canadian goods and services which they have imported. Canadians must likewise make payments abroad in the money of the country to which they are remitting. London, New York, Paris and Berlin importers must pay in Canadian dollars for the Canadian goods they buy. Canadian importers who buy British, American, French or German goods must pay for them in sterling, American dollars, French francs or reichsmarks. Where will foreigners obtain Canadian dollars and where will Canadians obtain foreign money? In important financial centres, such as London and New York, are money markets in which the various kinds of money are traded in. This money is in the form of bills of exchange. Bills of exchange drawn on foreign countries are called foreign exchange.

Bills of exchange used in international transactions are similar to drafts used within the country in inland or domestic exchange. Bills which do not cross the ocean are usually in the form of solo of exchange, i.e., only one copy of a bill is made. When bills cross the ocean they are usually sent in first and second of exchange, i.e., the first is sent by one mail and the second by a succeeding mail. The bill which arrives first is presented for acceptance; the other bill is regarded merely as a confirmatory duplicate. Some importers make arrangements with their banks to have exporters draw their bills on a bank. This is done by obtaining letters of credit from the banks. Bills are drawn against this credit. Because bank credit is more reliable than personal credit, bills drawn on a bank are not discounted as heavily as other bills.

**Settling Foreign Accounts.** In the great financial centres such as London and New York we find dealers in bills of exchange: the large commercial banks, private bankers, foreign

exchange brokers and commercial bill brokers. Their business consists in buying and selling foreign exchange. Through them accounts are automatically settled between the various countries. Equipped with batteries of telephones and flash signals they are constantly in touch with one another as effectively as if they were brokers dealing on the floor of a stock exchange. By buying and selling foreign exchange they provide channels for the settlement of foreign accounts. The following example will show how a bill drawn in one country is cancelled against a bill drawn in another country.

A. The Smith-Brock transaction. Let us suppose that John Smith is an apple exporter living in Halifax, Nova Scotia, and Harry Brock is a London importer. John Smith, sending Brock a consignment of apples worth £100, at the time of shipping draws a bill on Brock, payable thirty days after sight, for £100, and attaches to the bill all documents covering the shipment, i.e., bills of lading, insurance and inspection certificates and invoices. This is known as a documentary bill. John Smith then deposits the bill with his bank, say, the Canadian Bank of Commerce, where his deposit is credited with the equivalent of the bill of exchange in Canadian money. The Canadian Bank of Commerce then sends the documents to their London agent, the Bank of Scotland, that the bill may be collected. The Bank of Scotland notifies Harry Brock that it holds a bill drawn against him. As he cannot obtain his apples from the steamship company unless he has the bill of lading, he calls at once at the office of the Bank of Scotland and accepts the bill by writing across the face: "Accepted, Harry Brock (with date)." The documents are then surrendered to him.

B. The Bruce-Simon transaction. Let us suppose, now, that James Bruce, an exporter of fine Scotch plaid, receives an order of £100 from Isaac Simon, a Canadian merchant. We shall suppose also that James Bruce has an account with the Bank of Scotland. James Bruce draws a bill against Isaac Simon for £100 and deposits this bill with the Bank of Scotland for collection. The bill is then forwarded to the Canadian Bank of Commerce for collection. The Canadian Bank of

Form 10

*Halifax N.S., Oct. 6, 1934.* £ 100 - 0 - 0

*Thirty days* after  
*sight of this FIRST of Exchange (Second unpaid) pay to the order of*  
*The Canadian Bank of Commerce the sum of*  
*One Hundred Pounds* Sterling

*Value received, and charge the same to account of*

*To Harry Brock*

*123 Import St. John Smith*

*No. 3 London, England.*

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Form 10

*Halifax N.S., Oct. 6, 1934* £ 100 - 0 - 0

*Thirty days* after  
*sight of this SECOND of Exchange (First unpaid) pay to the order of*  
*The Canadian Bank of Commerce the sum of*  
*One Hundred Pounds* Sterling

*Value received, and charge the same to account of*

*To Harry Brock*

*123 Import St. John Smith*

*No. 3 London, England.*

FIG. 21. A BILL OF EXCHANGE

Commerce notifies Isaac Simon that it holds a bill for £100 drawn against him. As soon as he calls at the office of the Canadian Bank of Commerce and accepts the bill, the documents are surrendered to him.

After the Smith-Brock transaction is completed, the Bank of Scotland owes the Canadian Bank of Commerce £100, and the Canadian Bank of Commerce is indebted to the Bank of Scotland for £100 on the Bruce-Simon transaction. These two debts cancel each other without any money shipment taking place. Since these bills are in terms of sterling and payable in London, they are known as sterling exchange.

**The Rate of Exchange.** The transactions described in the preceding section were in terms of the British pound. The £100 bill drawn by John Smith on Harry Brock was converted into Canadian dollars before being credited to John Smith's account. The rate of conversion of one kind of money into another is called the rate of exchange. It is determined by the supply and demand of bills and other items of foreign exchange in the large financial markets such as exist in London and New York. Let us single out the Canadian dollar as an example. There is always a supply of Canadian dollars moving into the New York market. These Canadian dollars are sent there largely by Canadians making payments abroad who wish to buy pounds, American dollars, francs, marks and other currencies. On the other hand, there is always a demand for Canadian dollars by foreigners who wish to make payments in Canada. The Canadian dollars we send to New York are the supply; the Canadian dollars bought in New York are the demand. By applying the relationships we have previously noted between supply, demand and price, we can readily understand that the price of the Canadian dollar, in terms of other currencies, must fluctuate in the market. Similarly, the price of any other currency, expressed in Canadian dollars, is subject to the same changes.

**Smoothing out Fluctuations in the Exchange Rate.** The desirability of preventing wide fluctuations in the rate of exchange is obvious especially to the importer who must vary his prices according to fluctuations. These changes also destroy the effectiveness of tariffs and give undue advantages to certain classes of foreign competitors. We have in the normal working of the gold standard the most effective agency for removing these fluctuations.

**The Gold Standard.** The unit of money among countries on the gold standard was defined as a certain weight of gold, and it was possible at any time to buy gold from or sell gold to the central bank or some other authority entrusted with the gold reserve. The Canadian and the American dollars were

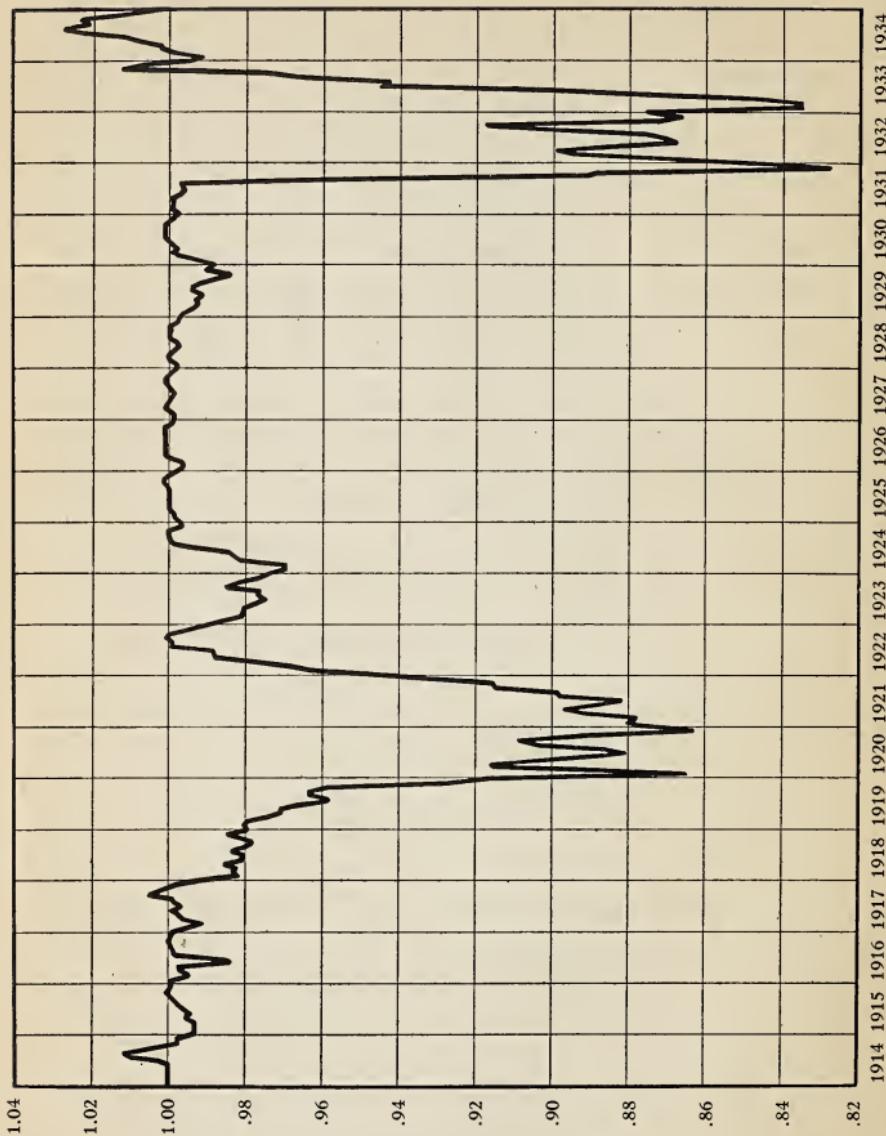


FIG. 22. THE CANADIAN DOLLAR IN NEW YORK

defined as equal to 23.22 grains of pure gold. The pound sterling contained 113.0015 grains of pure gold. Expressed in terms of dollars, the value of the pound sterling was 113.0015 divided by 23.22 or 4.86 times the value of the dollar. A pound sterling was worth \$4.86. This was called the par of exchange. For historical reasons, the exact value of the pound sterling was \$4.86 $\frac{2}{3}$  in Canada and \$4.8665 in the United States. Although this difference seems trivial it amounted to \$170 on £1,000,000. The par of exchange of other currencies was determined in the same way.

When the rate of exchange rose above or fell below the par of exchange, it became profitable to ship gold as long as the difference was sufficient to pay shipping costs, interest and insurance charges. These shipments served to even out fluctuations. If a Canadian banker found that a debt could be paid in New York by buying gold and shipping it for less than he could buy bills of exchange, gold was shipped. If the bank had bought a bill of exchange the rate of exchange would have gone up further, because the transaction, by increasing the supply of Canadian dollars going to New York, would cheapen it in terms of American dollars and, consequently, raise the price of American dollars in terms of Canadian dollars. Gold shipments out of Canada, therefore, prevented the further weakening of the Canadian dollar.

At other times the Canadian dollar was strengthened in New York. Instead of being at a discount or at par, Canadian dollars were at a premium. The price of Canadian dollars in terms of American dollars went up, whereas the price of American dollars in terms of Canadian dollars went down. If the price moved downward to a certain degree, Americans wishing to make payments in Canada found that they could ship gold more cheaply than they could buy bills of exchange. Gold shipments into Canada did not increase the rate of exchange, as did the purchase of bills of exchange, because the demand for Canadian dollars was not increased. Consequently, gold shipments into Canada prevented a further rise of the Canadian dollar.

**Gold Points.** The point in the rate of exchange where it became profitable to export gold to New York was called the

export gold point, and the point where it became profitable to import gold from New York was called the import gold point. When it cost \$1.0014 (Canadian) to buy an American dollar it was more profitable to ship gold to New York. As the price of American dollars fell beyond \$0.9989 (Canadian) it became profitable to import gold from New York, or, looking at it from the American viewpoint, when a Canadian dollar cost \$1.0014 (American) it became profitable to export gold from New York

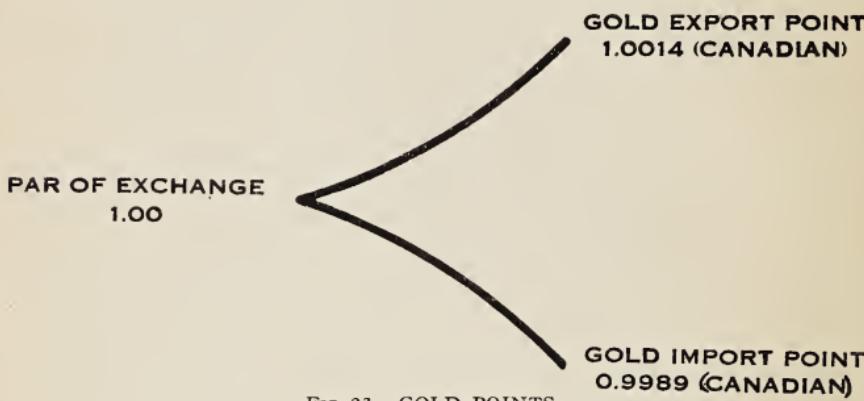


FIG. 23. GOLD POINTS

to Montreal. Obviously, when an American dollar costs \$0.9989 (Canadian) in Montreal, a Canadian dollar will cost \$1.0014 (American) in New York.

**Futures.** Bills of exchange are made payable at sight or after 8, 30, 60 or 90 days. Bills made payable after a period of time can be used to hedge international trade operations in the same way as the miller uses wheat futures to protect himself against loss. A Vancouver importer who has bought in Japan raw silk for which he will have to pay in London in 90 days has no way of telling how much the silk actually costs him unless he knows how much he will be forced to pay for sterling in 90 days. The Canadian manufacturer who, in February, sells automobiles to a London dealer for delivery in May, cannot figure his returns unless he knows how much he will receive for his sterling bills in May. To remove the element of speculation and to place the transaction on a business basis, the Vancouver

importer buys a future and the automobile manufacturer sells a future, which is a contract to accept or to deliver bills of exchange at a future date. Exchange futures affect the rate of exchange in the same way as wheat futures affect the price of wheat.

**Cable Transfers.** The only difference between a bill of exchange mailed overseas and a cable transfer is that the bill does not reach its destination before a week or ten days, whereas the cable transfer takes only a matter of minutes and sometimes of seconds. Cable transfers are sent in carefully guarded codes. They are especially important in arbitrage transactions. The price of Canadian dollars may vary momentarily between London and Paris, although sterling and French exchange remain unchanged. If the Canadian dollar is higher in London, a Montreal operator will promptly sell Canadian dollars in London and buy them back in Paris at the lower rate. Since these spreads are immediately noticed by other bankers who try to profit by them, the operator must be alert and quickly responsive to the situations thus created in the market.

#### EXERCISES AND PROBLEMS

1. Why are international payments made in the money of the country in which the payee resides? What is (a) foreign exchange? (b) sterling exchange?
2. What is meant by first and second of exchange?
3. Why are bills drawn on banks worth more than bills drawn on merchants?
4. Describe the Smith-Brock and Bruce-Simon transactions.
5. Define rate of exchange. What factors determine the rate of exchange?
6. How does an import item in the balance of international payments affect the external value of the Canadian dollar?
7. When is the Canadian dollar said to be (a) at a premium (b) at a discount in New York?
8. Why is it desirable to prevent fluctuations in the rate of exchange?
9. What is the legal definition of the money unit in a gold standard country?
10. What was the value of an ounce of gold in Canada when our dollar was equivalent to 23.22 grains of pure gold?
11. When is gold shipped out of a gold standard country? What are gold points? At what point did it pay to ship gold from Montreal to New York?
12. When the Canadian dollar is worth 80 cents in New York, what is the value of the American dollar in Montreal?
13. When the Canadian dollar is worth more than the American dollar is the premium on Canadian funds larger than the discount on American funds? Why or why not?
14. What are futures in the foreign exchange market?
15. What are cable transfers?

## CHAPTER XVIII

### THE CANADIAN TARIFF

**Definition.** To prevent goods from entering the country, or to limit the quantity of a certain type of import, the government imposes at the point of entry a tax which is collected at the customs house. There are customs houses in all cities or towns designated as ports of entry. This tax varies from article to article. The various rates levied are listed in the official schedule of custom duties, known as the tariff. The term tariff is used also to designate the duty on a particular class of goods.

#### Kinds of Tariff.

##### 1. *According to Purpose.*

(a) Protective tariff. To preserve the home market for home industries, governments usually impose tariffs designed to exclude foreign products of a class or kind produced within the country. The main purpose of this kind of tariff is to assist domestic producers by removing foreign competition. To be really protective the rate must be high enough to enable the domestic producer to undersell his foreign competitors.

(b) Revenue tariff. This tariff is designed to bring revenue to the government. Hence, the rates are set at the point of highest net returns. If it is too high, it restricts imports and lowers revenue. Consequently, it is generally a relatively low tariff.

(c) Dumping duties. Articles exported to Canada of a class or kind made or produced in Canada are subject to a further duty of fifty per cent. when sold here at a price lower than the fair market value in the country of origin. The reason for this additional levy is to afford greater protection against those who would take undue advantage of the Canadian market.

##### 2. *According to the Nature of the Rate.* Duties are levied in one or both of two ways.

(a) Specific duties. When the customs duty is a specific

amount levied on an article, it is known as a specific duty. A duty of \$1 on a pair of shoes is a specific duty.

(b) *Ad valorem* duties. In some cases the duty is a percentage of the value of the article.

A thirty per cent. duty on a camera is an *ad valorem* duty. If the camera is priced at \$20 the duty will be \$6.

3. *According to Countries.* There are three separate tariff schedules in force in Canada. The application of any one schedule is determined by the degree of political and trade relationship existing between the country of origin and Canada. Nations which accord us a better treatment than they give other countries are given lower rates.

(a) British Preferential Rates. Special rates called British preferential rates are accorded the United Kingdom and certain other parts of the Empire. These rates are the lowest in the Canadian custom schedules.

(b) Intermediate rates are granted to countries which have signed commercial treaties with Canada and are entitled to most-favoured-nation treatment. Although higher than the preferential rates, they are lower than those enforced on imports from other countries.

(c) The general rates are the highest rates in force. They apply to countries which do not see fit to grant us any concessions.

**Drawbacks.** Our manufacturers import part of their raw and semi-processed materials from abroad. A custom duty levied on these materials increases the manufacturer's costs. To assist our industry against its foreign competitors the duty is refunded when the articles are manufactured for export. These refunds are called drawbacks and amount to 99 per cent. of the duty paid. In this way the manufacturer's costs are lowered to a point at which he is able to compete in world markets.

#### HISTORY OF THE CANADIAN TARIFF

**In New France.** France, like other countries with colonies in the seventeenth century, enforced a colonial policy which

had for its object the particular interest and prosperity of the parent country. The trade and commerce of the colony were confined to the parent country, and the right of trading was granted exclusively to particular companies. This policy meant a condition of monopoly which left no need for tariff schedules.

**Under British Rule.** The same colonial policy was enforced by Great Britain. Her purpose was to secure to herself the carriage of the produce of her colonies, to monopolize their raw materials, and to supply the settlers with all the imported articles they consumed. The interest of the parent country was kept uppermost in mind at all times. This is evidenced by the fact that in 1804 a law was passed imposing the high duty of 24s. 3d. per quarter on all wheat imported from Canada when the home price was under 53s. per quarter. This duty was revoked and a preference was granted when wheat was needed for her expanding industrial population. There was no trade allowed between Canada and the American colonies which later became the United States. Under such conditions smuggling was prevalent and as colonization advanced westward it became general in the outlying parts of the colony. This situation continued until 1822 when Great Britain made substantial concessions to United States traders in respect of the Canadian trade. In 1846 the preferential treatment previously accorded to Canadian wheat was withdrawn and in 1860 the last traces of preference to colonial products were removed from the British tariff.

**Reciprocity Treaty of 1854.** When Great Britain became a free trade country no preferences could be extended to Canadian products because a preference presupposes the levying of protective duties on imports from other countries. The British North American Colonies then saw fit to negotiate a reciprocity treaty with the United States. Negotiations went on during 1854, and on March 16, 1855, the treaty became effective. It provided for the free exchange of natural products between the contracting parties. It did not apply to the products of the manufacturing industries. However, the Canadian farmer and

fisherman derived considerable benefit from its operation. This treaty was denounced by the United States in 1865 and ceased to operate in 1866.

**The Galt Report.** With the adoption of a free-trade policy by Great Britain the British North American colonies which were already enjoying responsible government claimed the right to control their own commercial policy. This was intimated to the British Government in a report made by Sir A. T. Galt in 1859. The Galt Report stressed the necessity of giving the Canadian Government full control in the matter of taxation. At that time the greater part of the revenue was raised by customs duties. The report affirmed the right of the Canadian Parliament to adjust taxation according to the best interests of the Canadian people regardless of any divergence of opinion the British Ministry might entertain. The Galt Doctrine remained unchallenged, and the Province of Canada in 1859 set up a protective tariff to foster the development of manufacturing industries. This protective tariff which shut out manufactured goods from the United States was instrumental in bringing about the abrogation of the Reciprocity Treaty of 1854.

**After Confederation.** The protective tariff of the old Province of Canada which had become law in 1859 was replaced in 1866 by a lower schedule. The Maritime Provinces had applied only a revenue tariff and the lower rates agreed with sentiment in these parts of the prospective Dominion. A world-wide depression forced an upward revision in 1873; in 1878, Sir John A. Macdonald's National Policy of protection won him the favour of the electorate. Consequently, in 1879, a new upward revision was passed through Parliament, and the manufacturers were granted added protection. Until 1890, all changes were upwards, but in 1891 the duty on raw sugar was repealed. The year 1894 saw important reductions made in the tariff on agricultural implements.

**Reciprocal Duties.** Although the tariff revision of 1897 contained many downward revisions, its special importance was in the introduction of reciprocal duties. This reciprocal tariff

was one-eighth lower than the general rate. It was immediately applied to the United Kingdom and subsequently to New South Wales and British India. Then complications set in. Foreign countries which had signed most-favoured-nation treaties with Great Britain demanded the same treatment. Germany and Belgium were the most notable examples of countries which exacted these concessions. The next year Great Britain denounced her commercial treaties with Germany and Belgium, a move which left us free to limit our lower tariff rates to the United Kingdom and to other parts of the Empire.

**British Preference.** On August 1, 1898, a new method of favouring Empire trade was inaugurated. A British preferential tariff was established. It consisted in a remission of one-fourth of the duty collected. On July 1, 1900, this preference was increased to one-third. Another new method of preference was adopted in 1904. Specially low rates on commodities originating in certain parts of the Empire replaced the former method of remitting a part of the ordinary duty. In 1907 was adopted a new Canadian customs tariff, which contained three separate schedules, British preferential, intermediate and general. This tariff, although several times amended, is still in force. Modifications have not changed the fundamental policy pursued by Canada in tariff matters. Canada, in recent years, has consistently followed the principles of protection and of Empire Preference, granting concessions only to those countries which are in a position to reciprocate. The accompanying table shows the changes which have occurred in the rate of duty collected on all imports since the beginning of the present century.

**The Imperial Economic Conference, 1932.** Faced with a declining volume of world trade, Empire countries met at Ottawa, in 1932, to discuss ways and means of improving trade within the Empire. Eleven separate agreements were signed. Four of these affected Canada. These were entered into between Canada and the United Kingdom, Canada and the Irish Free State, Canada and the Union of South Africa and Canada and Southern Rhodesia. Existing preferences were renewed and

new concessions were granted on a mutual basis. The purpose was to stimulate trade within the Empire. With this aim in view the contracting parties agreed to raise their tariff on foreign goods. A significant feature of the Canada-United Kingdom agreement is the provision to establish a Tariff Board in Canada.

TABLE 22

AVERAGE AD VALOREM RATES OF DUTY COLLECTED ON  
DUTIABLE AND TOTAL IMPORTS FROM UNITED KING-  
DOM, UNITED STATES AND ALL COUNTRIES,  
IN THE FISCAL YEARS 1900-1934

Fiscal Year	United Kingdom		United States		All Countries	
	Dutiable Imports.	Total Imports	Dutiable Imports	Total Imports	Dutiable Imports	Total Imports
1900.....	p.c. 25.6	18.2	p.c. 25.0	13.2	p.c. 27.7	16.7
1901.....	24.7	18.3	24.8	12.4	27.5	16.4
1902.....	24.0	17.2	25.2	13.2	27.3	16.5
1903.....	23.3	16.7	24.9	13.3	27.1	16.5
1904.....	24.1	17.6	25.2	13.6	27.5	16.8
1905.....	24.8	18.5	26.1	13.5	27.8	16.7
1906.....	24.6	18.7	24.8	13.1	27.0	16.4
1907—9 ms.	24.3	18.4	24.2	12.8	26.5	16.1
1908.....	24.2	18.3	24.6	13.2	26.7	16.5
1909.....	25.8	19.0	24.9	13.2	27.5	16.7
1910.....	25.1	18.9	24.8	13.5	26.8	16.5
1911.....	24.6	18.9	24.7	13.7	25.9	16.2
1912.....	25.0	19.1	25.0	14.8	26.1	16.8
1913.....	25.1	19.6	24.9	15.8	26.1	17.1
1914.....	25.2	19.5	24.8	15.6	26.1	17.3
1915.....	27.1	20.5	25.1	14.2	27.4	16.8
1916.....	28.4	19.1	25.0	13.5	27.2	15.5
1917.....	24.9	17.6	22.7	11.4	23.8	13.0
1918.....	24.3	17.3	20.5	11.1	21.5	12.1
1919.....	22.3	15.3	20.9	11.6	21.5	12.3
1920.....	22.1	16.2	22.5	14.0	22.5	14.7
1921.....	20.9	16.6	20.3	12.9	20.6	14.1
1922.....	24.8	20.1	23.0	13.9	24.5	16.2
1923.....	24.5	20.1	22.5	13.8	24.9	16.7
1924.....	22.3	18.3	22.3	13.2	22.9	15.1
1925.....	22.1	18.2	23.1	13.0	23.3	15.1
1926.....	21.6	18.4	23.9	13.3	24.7	15.5
1927.....	23.9	19.7	23.1	13.2	24.1	15.4
1928.....	25.6	20.6	23.3	13.5	24.2	15.5
1929.....	25.9	20.6	23.4	14.1	24.4	15.8
1930.....	25.5	20.0	23.3	14.4	24.3	15.9
1931.....	26.9	19.5	24.8	15.2	26.0	16.4
1932.....	29.2	21.9	27.4	17.9	29.3	19.7
1933.....	25.8	16.6	28.1	17.4	30.1	19.0
1934.....	26.2	14.2	28.4	16.7	29.1	16.8

**The Tariff Board.** As a sequel to the Ottawa Conference, the Tariff Board Act, which had become law on August 3, 1931, was put into effect. Subsection (1) of section 4 of the Tariff Board Act outlines the duties and powers of the Board. "In

respect of goods produced in or imported into Canada the Board shall, at the request of the Minister, make inquiry as to,

- (a) the price and cost of raw materials in Canada and elsewhere, and the cost of transportation from the place of production to the place of use or consumption;
- (b) the cost of efficient production in Canada and elsewhere, and what increases or decreases in rates of duty are required to equalize differences in the cost of efficient production;
- (c) the cost, efficiency and conditions of labour, including health of employees, in Canada and elsewhere;
- (d) the prices received by producers, manufacturers, wholesale dealers, retailers and other distributors in Canada and elsewhere;
- (e) all conditions and factors which affect or enter into the cost of production and the price to the consumers in Canada;
- (f) generally, all the conditions affecting production, manufacture, cost and price in Canada as compared with other countries; and report to the Minister.

The Tariff Board is also empowered to make investigations as authorized by the Combines Investigation Act. Moreover, the new Board assumes all the powers, functions and duties of the Board of Customs.

**Protection and Free Trade.** A free trade country is one which does not levy a tariff on imports other than a purely revenue tariff. Great Britain was the traditional country of free trade until the recent reversal of her tariff policy. Free trade implies free movement of foreign merchandise into a country. Protection implies a restriction on the importation of goods from abroad. The purpose of protection is to foster the development of manufactures within the country, to diversify industry and generally to make the nation as self-sufficient as its natural resources will permit.

#### **The Case for Protection.**

1. Protection promotes national unity. In Canada, trade flows in an east-west direction. Removal of protection would cause trade to move in a north-south direction. This would

sever the commercial bonds between Eastern and Western Canada and would very likely lead to the breaking of political ties. The outcome might very well be the setting up of four different political units made up of British Columbia, the Prairie Provinces, the Central Provinces, and the Maritime Provinces. Protection is essential to Canadian unity.

2. Protection preserves our industries and diversifies our economic enterprises. Canada might abolish protection, destroy that part of our manufacturing industries over which similar manufactures abroad enjoy a comparative advantage, and become, once more, after a period of difficult adjustments, mainly an agricultural country. No long explanation is required to show that we would lose the many advantages in variety of enterprise and opportunity offered by our present industrial economy.

3. The war potential argument. A nation specializing in the production of a small number of commodities and depending on other nations for the supply of all other commodities would be at the mercy of the rest of the world in the unfortunate event of a declaration of war. Protection is necessary where a country is exposed to invasion or to a blockade. European nations are imposing tariffs on wheat to increase its production, regardless of cost, as a measure of protection in case of war.

4. The anti-dumping argument. Dumping consists in selling goods abroad at a price lower than the fair market value in the country of origin. Dumping is a method of lowering the cost of production by increasing sales. Suppose a Canadian manufacturer of electric stoves has the following market and cost problem.

Home market will take:

5,000 stoves at \$60 each.....	\$300,000
Cost of stove, \$40	
Total cost, 5,000 x \$40.....	200,000
Profit.....	\$100,000

This manufacturer may have a factory with a capacity of 10,000 stoves. If he uses his plant to full capacity he may be able to lower his cost of production to \$30. Suppose he can sell 5,000

stoves abroad for \$30 each. Then his market and cost problem becomes the following:

Home market will take:	
5,000 stoves at \$60 each.....	\$300,000
Foreign market will take:	
5,000 stoves at \$30 each.....	150,000
Total sales .....	<u>\$450,000</u>
Cost of stove, \$30	
Total cost, 10,000 x \$30.....	\$300,000
Profit.....	\$150,000
Old profit.....	<u>\$100,000</u>
Profit from dumping.....	\$50,000

By selling abroad at this low price our manufacturer of electric stoves may ruin his foreign competitors. It is only fair that governments should protect their manufacturers against this type of competition. However, much of the criticism of dumping is created by the practice of refunding custom duties in the form of drawbacks.

5. The subsidy argument. Certain foreign governments pay bonuses, or subsidies, to manufacturers who export a part of their production. The payment of this bonus is made possible by placing a sales tax on the goods sold at home. The tax raises the price at home, and with the application of the bonus to the exports, lowers the price abroad. This is a form of unfair competition closely related to dumping and similar in its effects. The home producer should be protected against such methods.

6. Certain governments manipulate the value of their money to gain an unfair advantage over foreign nations in world trade. When a government depreciates the money of the country all the exports of that country are brought down to lower prices in terms of other currencies. This gives the exporters an advantage over all foreign competitors equal to the spread between the new price and the old price. Governments are sometimes forced to depreciate their currency. When the franc was worth 19.3 cents in terms of our money a hundred-franc article sold

for \$19.30 to the Canadian importer. At the new par of 3.93 cents it sold for \$3.93. Depreciation of the franc gave all French exporters an added advantage. Other nations usually apply dumping duties against nations which voluntarily depreciate their currency.

**The Case for Free Trade.** 1. Free trade is essential to the development of the international division of labour. The advantages derived from the international division of labour are obvious to all who have studied the history of commerce. World production, in practically every commodity, has increased whenever that commodity was produced in the best conditions obtainable. Production under best conditions is possible only when nations specialize in the lines for which they are best fitted. Tariffs hamper specialization.

2. Free trade is in harmony with the law of comparative advantage. If a country can produce goods more cheaply than other countries, international trade will be created. Then each country will produce only those goods which it can produce more cheaply. Under these conditions of comparative advantage, each country will employ capital and labour in the most efficient manner. Tariffs, by blocking the natural channels of trade, will prevent the best use of capital and labour, and will shift the people's industry from more productive to less productive enterprises. The classical illustration used to demonstrate this point is that of the lawyer and his stenographer. The stenographer can turn out letters more efficiently than the lawyer. Protection aims at having lawyers write their own letters because lawyers are, as a rule, more intelligent than stenographers, and, if given reasonable time, will do their work more efficiently than stenographers.

3. Free trade is a war preventive. Under an international free trade régime the powers would soon become completely interdependent. Nations declare war only when they approach self-sufficiency. Anything which destroys self-sufficiency is a step forward in the prevention of war.

4. Tariffs are notoriously unstable. As soon as the trade of the world has adjusted itself to certain tariff combinations,

some important country changes its tariff and destroys the equilibrium existing between the various trading nations. This leads to retaliation on the part of affected countries and tariff walls mount higher and higher. The ultimate result is a general decrease in world trade.

5. Tariffs raise the cost of living. A duty on imported wheat raises the price of all wheat consumed in the country. If 50,000,000 bushels of wheat are consumed, of which 10,000,000 bushels are imported, the levy on the imported wheat will raise the price on the whole 50,000,000 bushels. As well, the protection afforded to the home producer is unfairly distributed. The farmer who owns a good farm which yields 40 bushels per acre will benefit twice as much as the farmer who cultivates a farm which yields 20 bushels per acre. Protection favours most those who need no assistance.

**Summary.** Regardless of what may be said in favour of free trade or against protection, the fact remains that any change in one direction or the other must be a slow change. Violent social changes are never desirable. They break the equilibrium existing between the various enterprises in the economic system without providing time for readjustments. Since readjustments are always slow, changes which demand readjustments should be cautiously effected. As someone once remarked: "It is smooth sailing above the falls, and it is smooth sailing below the falls, but it is mighty rough in between."

#### EXERCISES AND PROBLEMS

1. What is (a) a tariff? (b) a protective tariff? (c) a revenue tariff?
2. What are (a) dumping duties? (b) specific duties? (c) ad valorem duties?
3. What are (a) British preferential rates? (b) intermediate rates?
4. To what countries apply Canada's general tariff rates?
5. What are drawbacks? To what class of imports are drawbacks applied?
6. Write an essay on the history of the Canadian tariff.
7. State the principal clauses of the Reciprocity Treaty of 1854. (Consult standard Canadian History texts.)
8. Explain reciprocal duties.
9. What is meant by most-favoured-nation treatment?
10. Describe the development of Canada's British Preference policy.
11. What were the purpose and the results of the Imperial Economic Conference held in Ottawa in 1932?
12. Outline the functions of the Tariff Board.
13. State the case for (a) protection; (b) free trade.

## CHAPTER XIX

### PUBLIC FINANCE

**The Functions of Government.** Although some people think of the government as an unnecessary burden, a wise man recognizes that the government is an agent of production just as important as labour, land or capital. Taxes are as justifiable as wages, rent, profit and interest: all these payments are made for productive purposes. The productive functions of government are numerous. The following is a classification of the chief productive and incidental functions of the government.

1. The institution of private property is protected by the government. In our economic system this institution is fundamental. Property is the exclusive right to the use of wealth. Unless this right were enforced by law, only the strong would be in control and the weak would be eliminated from ownership. Such a tendency is always evident where new wealth is found and taken over by individuals before the police are at hand. In a gold rush the best claims are appropriated by those who are able to remove their competitors without regard for their prior rights. The same situation would rule throughout a society which lacked the presence of the strong arm of the law.

2. Contracts are enforced by the government. Individuals are free to bind themselves to do, or to cause to be done, certain specified things, usually for a money consideration. Goods are sold on credit, leases are granted, money is borrowed, and goods are produced according to contract. All credit instruments are contracts. Anything which would destroy faith in the sanctity of contracts would impair society's ability to carry on business. That function of government which protects the freedom of contract, and enforces contracts once they are entered into, is one of the essentials of modern society.

3. Compulsory education provided by the state is another indispensable institution in modern society. Public schools

and state universities are supplemented by extensive public libraries. Illiteracy is fast vanishing in the modern world. A result of the education of the people is that wants are diversified and productivity is enhanced by the improvement of the quality of the labour force. Although education is the most costly of all government functions, it is the most remunerative in terms of an increased national output.

4. The maintenance of peace within the country comes within the scope of the police function of the state. To this end we have municipal, provincial and Dominion police forces. Canada is a member of the League of Nations, whose principal endeavour is to preserve world peace. Many governments have large standing armies and powerful navies to acquire respect among their neighbours.

5. Public welfare is to-day the concern of government in every civilized nation. Unemployment relief, compensation, minimum wage, factory sanitation and child-labour laws are the chief aspects of labour legislation. Public health is the object of numerous activities which include hospitals, free clinics, publicity and general sanitary measures. Playgrounds and public parks provide community recreation. Sumptuary legislation such as pure food and temperance laws also come under the heading of public welfare.

6. Public ownership is becoming a more and more important function of government. Government enterprise, as we have seen, is especially important in Canada.

7. The administration of the public domain, the promotion of foreign trade, time and weather bureaus, research and experimental activities are only a few of numerous miscellaneous functions.

**Public Finance.** To perform these functions the government must have revenue. This revenue is obtained through taxation and, when expenditures exceed revenue, through borrowing funds from corporations and individuals. Public finance is therefore the study of public revenue and public expenditure. Government functions, in Canada, are divided

among Dominion, provincial and municipal bodies. The following statements of Dominion, provincial and municipal expenditures and revenues reveal their relative importance.

TABLE 23  
DOMINION PUBLIC FINANCE

Revenue and Expenditure in Thousand Dollars. (Add 000)

	Fiscal Years				
	1929-30	1930-31	1931-32	1932-33	1933-34
Taxation Revenues—					
Customs Import Duties.....	179,430	131,209	104,133	70,073	66,305
Excise Duties.....	65,036	57,747	48,655	37,834	35,494
War Tax Revenues—					
Banks.....	1,408	1,429	1,390	1,328	1,336
Insurance companies.....	74	74	12	826	742
Delayed business profits.....	173	34	3	—	—
Income Tax.....	69,021	71,048	61,255	62,067	61,399
Sales Tax.....	44,859	20,784	41,734	56,814	61,392
Manufacturers' importation, stamp, transportation, taxes, etc.....	18,550	13,951	17,872	25,377	45,184
Total receipts from Taxation.....	378,551	296,276	275,054	254,319	271,852
Total Non-Tax Revenues.....	62,787	53,291	51,757	52,319	52,210
Special Receipts.....	4,771	6,622	7,028	4,493	418
Grand Total.....	446,109	356,189	333,839	311,130	324,480
Expenditure Ordinary Account—					
Agriculture.....	10,245	10,119	10,212	8,066	6,996
Auditor General's Office.....	402	416	436	380	376
Civil Service Commission.....	308	343	306	244	221
External Affairs, including Office of the Prime Minister.....	897	928	994	863	974
Finance.....	140,051	144,374	140,960	153,896	159,775
Fisheries.....	2,426	2,435	2,046	1,787	1,596
Governor General's Secretary's Office.....	170	142	148	136	136
Immigration and Colonization.....	3,094	2,588	2,200	1,689	1,369
Indian Affairs.....	5,333	6,069	5,081	4,499	4,380
Insurance.....	159	178	180	161	152
Interior.....	8,490	8,104	4,647	3,454	2,833
Justice.....	5,152	5,775	5,297	5,328	5,111
Labour.....	2,647	6,846	10,948	12,320	13,003
Legislation.....	2,339	4,686	2,937	3,159	1,434
Marine.....	8,944	8,030	7,262	5,950	6,464
Mines and Geological Survey.....	1,414	1,934	1,985	2,268	3,681
National Defence.....	21,892	23,626	18,130	13,695	13,421
National Revenue (including Income Tax).....	13,844	13,972	13,920	10,846	10,354
Pensions and National Health.....	49,916	56,657	60,649	56,069	53,809
Post Office.....	36,557	37,892	36,052	31,607	30,554
Privy Council.....	58	54	53	47	49
Public Archives.....	203	212	212	174	157
Public Printing and Stationery.....	302	295	289	231	172
Public Works.....	19,819	25,453	17,648	13,108	10,827
Railways and Canals.....	7,215	8,094	6,552	5,588	5,304
Royal Canadian Mounted Police.....	3,100	3,192	3,488	5,626	5,315
Secretary of State.....	454	479	483	418	387
Soldier Settlement Board.....	1,362	1,300	1,036	818	810
Trade and Commerce.....	6,606	8,634	11,722	7,384	6,987
Total Ordinary Expenditure* .....	357,780	389,558	375,403	358,528	346,649

\*Totals include other items not specified.

TABLE 24

TOTAL ORDINARY REVENUES AND EXPENDITURES  
OF PROVINCIAL GOVERNMENTS FOR THEIR  
FISCAL YEARS ENDING 1932 AND 1933

	Total Ordinary Revenue		Total Ordinary Expenditure	
	1932	1933	1932	1933
Prince Edward Island.....	\$ 1,206,025.75	\$ 1,263,063.38	\$ 1,277,400.85	\$ 1,392,275.70
Nova Scotia.....	8,100,988.16	7,226,911.27	7,858,238.69	8,441,852.95
New Brunswick.....	5,795,630.02	5,176,468.35	6,360,893.40	5,605,985.39
Quebec.....	36,941,020.36	31,023,889.60	37,525,728.97	37,864,797.56
Ontario.....	54,175,233.01	51,373,051.98	52,173,086.91	50,896,626.37
Manitoba.....	14,631,341.34	12,366,918.15	14,631,341.34	14,311,482.87
Saskatchewan.....	11,902,646.59	14,834,887.95	17,722,936.39	15,413,524.82
Alberta.....	13,492,430.28	15,426,264.94	18,645,481.20	17,533,785.97
British Columbia.....	21,982,582.87	20,180,145.22	* 27,472,008.42	* 21,832,208.22
Total.....	168,227,898.38	158,871,600.84	183,667,116.17	173,292,539.85

\* Including Sinking Funds, "Capital Expenditure out of Income" \$2,098,682.75 in 1932 and \$890,030.75 in 1933.

TABLE 25

MUNICIPAL PUBLIC FINANCE, ALL CLASSES OF  
MUNICIPALITIES, YEAR 1932

	Revenue		Expenditure	
	\$	\$	\$	\$
Prince Edward Island*.....	328,904		391,297	
Nova Scotia.....	13,912,922		14,019,411	
New Brunswick†.....	5,499,556		5,415,256	
Quebec.....	86,401,290		57,787,244	
Ontario.....	169,020,853		166,920,664	
Manitoba†.....	17,290,888		not available	
Saskatchewan.....	24,489,255		16,138,576	
Alberta.....	29,806,533		28,821,449	
British Columbia.....	28,111,219		31,013,520	
Total.....	374,861,420		320,507,417	

\* City of Charlottetown, only.

† Cities of St. John and Moncton, only.

‡ "Taxes Collected."

**The Budget.** Before spending his income the private citizen tries to determine its size. Governments act differently. Having ascertained how much they will spend, they seek means to raise funds to meet their expenditures. Revenue and expenditure are estimated at the beginning of the fiscal year, and an itemized statement of the coming year's expenditures and revenues, called the budget, is prepared. Once the budget is

approved, an attempt is made to keep within its limits. At the end of the fiscal year the government may find that revenues have exceeded expenditures and that there is a surplus on hand; or expenditures may exceed revenues and leave the government with a deficit. There are numerous reasons why a public spending body should draw a budget.

1. To get the most for each dollar.
2. To estimate the revenue and to determine the source of revenue for the next fiscal year.
3. To limit taxation to needs.
4. To avoid surpluses and deficits.
5. To prevent civil servants or departments from overspending.

### PRINCIPLES OF TAXATION

**Taxation.** The community receives services from the government. These services cannot be rendered unless the community supports those who are engaged in performing them. Like the other members of society engaged in the work of production, they must receive a share of the output. To insure the payment of this share taxes are levied by the various governing bodies. A tax is a payment made for the services of government.

**The Incidence of Taxation.** Taxes do not fall equally on all taxpayers. Some get away lightly, others pay heavily. The incidence of a tax refers to the group of individuals who have to bear its burden. The incidence of the real property tax is limited to the owners of real property. Taxes are classified according to their incidence into direct and indirect taxes. A direct tax is a tax that cannot be passed on to someone else by the taxpayer; its incidence cannot be shifted. An indirect tax is a tax that can be passed on to others. Its burden is not borne by the original taxpayer who makes good his escape by shifting its incidence to other members of society.

**Proportional, Progressive and Regressive Taxes.** When a tax is levied it is sometimes asked whether A, who is taxed on

\$2,000, should pay the same rate as B, who is taxed on \$4,000. If the rate is the same, the tax is said to be proportional. If, on the other hand, the rate increases with the amount taxed, the tax is progressive.

	Proportional Tax		Progressive Tax	
Assessment	Rate	Tax	Rate	Tax
\$1,000.....	1%	\$10	1%	\$10
2,000.....	1%	20	2%	40
3,000.....	1%	30	3%	90
4,000.....	1%	40	4%	160
5,000.....	1%	50	5%	250

A regressive tax is the reverse of a progressive tax. The burden of this tax increases as the amount taxed decreases. A tax of \$50 on retail stores is an example. The store with a \$100,000 turnover pays no more than the store with a \$50,000 turnover.

**The Benefit Theory.** Some writers on taxation argue that a citizen should contribute to the cost of government in accordance with the amount of benefit he receives from the government. According to this theory, John Jones, who has two children going to school, should pay twice the tax paid by his neighbour, who sends only one child to school. Corporations should not contribute to the cost of education. This theory neglects the important fact that all the members of society derive indirect benefits from government services. These indirect benefits cannot be measured in terms of money. However, there are forms of government revenue based solely on the benefit theory. Fees and special assessments are levied only on those who receive certain services. It also fails to consider the impossibility of collecting from their inmates the cost of keeping houses of refuge, insane asylums and penal institutions.

**The Ability to Pay Theory.** A more prevalent theory of taxation is the ability theory. According to this theory the tax burden ought to rest more heavily on those who have large incomes than on those who have small incomes. Engel's law

reveals that small incomes must practically all be spent on necessities. Although this theory is not generally applied, because no single principle is sufficient to direct the making of tax laws, it is nevertheless becoming more and more popular. It is felt by most people that there should be equality of sacrifice among taxpayers.

**Measuring the Ability to Pay.** Since the collection of taxes depends on the ability to pay, it is important to find a yardstick with which to measure taxpaying ability. There are two measures available, (1) the possession of wealth, (2) income. The net amount, in each case, measures the taxpaying ability more accurately than does the gross amount of property or income. A and B may each own a \$10,000 farm. If A has debts of \$5,000 while B's farm is free and clear, the latter's taxpaying ability is greater. A's ability to pay should be measured by his net possessions, \$5,000. Our municipal real property tax is based on gross possessions, without regard to the fact that net possessions are the true measure of ability to pay. If income is to be the measure, there should be deducted from gross income all those disbursements which are necessary to secure the gross income. The result is the net income, a far better measure of ability to pay.

**Adam Smith's Four Canons of Taxation:** 1. "The subjects of every state ought to contribute toward the support of the government, as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.

2. "The tax which each individual is bound to pay, ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.

3. "Every tax ought to be levied at the time, or in the manner in which it is most likely to be convenient for the contributor to pay it.

4. "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible

over and above what it brings into the public treasury of the state."

**Kinds of Taxes:** 1. *Real Property Tax.* Municipalities derive most of their revenue from the real property tax. The first step in the collection of this tax is the assessment of all land and buildings within the municipality. This is a problem of valuation which consists in determining the actual value. No deductions are made for indebtedness. Hence this tax applies to gross possessions and not to net possessions. The next step is the striking of the tax rate. After consulting the various spending bodies, such as the Board of Education, the Library Board and the Parks Board, the municipal council determines the amount that must be spent during the following year. The tax rate is then set at a level which will bring the required revenue. It is arrived at by comparing the estimated expenditure with the total assessment. If, for example, the total assessment is \$2,000,000 and estimated expenditures are \$50,000, each \$1,000 of assessment must contribute \$25, the equivalent of 25 mills for each dollar of assessed property value. The individual tax bill is found by applying the rate to the assessed value of property. When the rate is 25 mills, the assessment \$3,000, the tax is \$75. This tax is considered by many to be the most unfair of all taxes levied. In the first place, disregarding the principle of ability to pay, it taxes gross possessions instead of net possessions. Secondly, it is practically impossible to determine a fair assessment value in each case over a large administrative area such as a county. Assessors have different methods of valuation which lead to inequalities. When variations are too wide, equalization boards are set up to rearrange the assessment. Courts of revision are also appointed to hear grievances from taxpayers who feel their property has been overassessed.

2. *Income Tax.* The income tax is a progressive tax levied on the net income of certain individuals and corporations. It was introduced in 1917 by the Dominion Government as a special war tax measure. British Columbia, Alberta, Saskat-



chewan and Manitoba are the only provincial governments levying income taxes. Municipalities also have resorted to this form of taxation in some provinces. A strong point in favour of this tax is its incidence on those who are able to pay. Since it is applied only on net income and since it grants reasonable exemptions, it does not work the hardships which follow the application of the general property tax.

Dominion income tax rates are as follows:

TABLE 26

Net Taxable Income in excess of statutory exemptions and allowances \$	Tax Payable on even \$1,000's \$	Rates applicable on excess over even \$1,000's %	Net Taxable Income in excess of statutory exemptions and allowances \$	Tax Payable on even \$1,000's \$	Rates applicable on excess over even \$1,000's %
Under 1,000		3	18,000	2,070	" 21
1,000	30	on excess 4	19,000	2,280	" 22
2,000	70	" 5	20,000	2,500	" 23
3,000	120	" 6	25,000	3,650	" 24
4,000	180	" 7	30,000	4,850	" 25
5,000	250	" 8	35,000	6,100	" 26
6,000	330	" 9	40,000	7,400	" 27
7,000	420	" 10	45,000	8,750	" 28
8,000	520	" 11	50,000	10,150	" 29
9,000	630	" 12	55,000	11,600	" 30
10,000	750	" 13	60,000	13,100	" 31
11,000	880	" 14	65,000	14,650	" 32
12,000	1,020	" 15	70,000	16,250	" 33
13,000	1,170	" 16	75,000	17,900	" 34
14,000	1,330	" 17	80,000	19,600	" 35
15,000	1,500	" 18	85,000	21,350	" 36
16,000	1,680	" 19	90,000	23,150	" 37
17,000	1,870	" 20	95,000	25,000	" 38
			100,000	26,900	" 39

An additional charge of 5 per cent. of the tax payable is made whenever the taxpayer's net income is in excess of \$5,000 after claiming exemptions for charitable donations but before deducting other statutory exemptions. Exemption may be claimed for charitable donations up to 10 per cent. of the net income. An unmarried taxpayer is granted an exemption of \$1,000. The exemptions for married taxpayers are \$2,000 and

\$400 additional for each dependent child or grandchild under twenty-one years of age.

3. *Sales Tax.* The sales tax is an ad valorem consumption tax levied by the Dominion Government on certain classes of imported and domestic goods. It is collected by collectors of customs and excise situated at the various customs ports throughout Canada. In the case of imported goods, the tax is paid when the goods are taken out of customs bond; in the case of domestic goods, it is paid within the month following that in which the transactions occurred.

4. *Other Forms of Revenue.* Customs import duties are the chief source of Dominion revenue. Excise duties and war tax revenues, other than income or sales tax, such as the manufacturer's importation tax and stamp taxes, account for a fairly large percentage of Dominion revenue.

The provinces rely for revenue mainly on the gasoline tax, motor licences, corporation taxes, succession duties and amusement taxes. The gasoline tax is an example of a very highly selective tax which places a large part of the burden of provincial finance on a certain group of taxpayers while many others equally able to pay escape its incidence.

**The Public Debt.** The net debt of the Dominion in 1914 was \$335,996,850. At present the Dominion's net debt, including contingent liabilities in the form of guaranteed bond issues floated for the purchase or development of government enterprises, stands at over ten times its 1914 level. The main factor responsible for this great increase in our national debt is war financing. Taxation proved insufficient as a means of raising revenue at this time of great national emergency, and large bond issues were sold to replenish the treasury. The fact that prices were abnormally high at the time of borrowing is significant in studying the problem of public indebtedness. The public borrowed short dollars and long dollars are being collected by holders of government bonds.

Provincial debts have also increased at a fast rate, but not to the same extent as the Dominion debt. The combined public

debt of all the provincial governments is approximately seven times greater than it was in 1914. Provincial public debts have been increased chiefly by highway construction and improvement, and by the development of government-owned public utilities.

Municipal indebtedness also has shown a tendency to increase rapidly during the last twenty years. The chief cause of the increase in municipal indebtedness has been the growth of urban population. Our rising standard of living as well, has been responsible for much local expenditure financed by the sale of bonds.

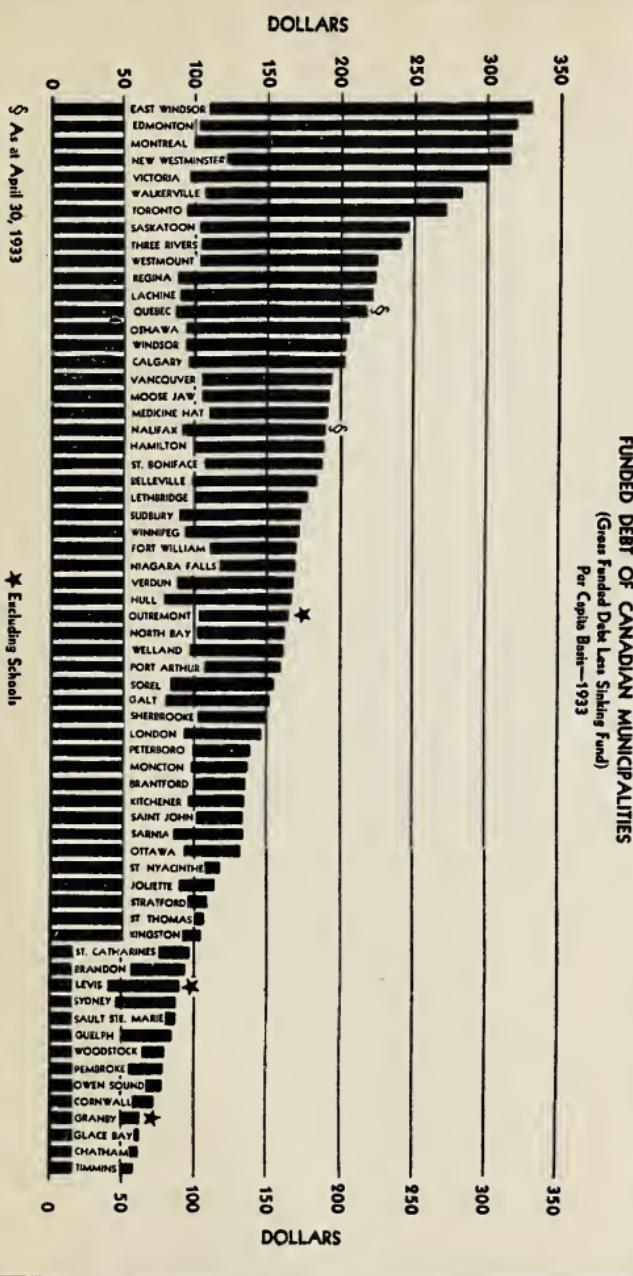
**Burden of Public Debts.** When bonds issued by Dominion, provincial or municipal governments are held within the country, the problem of meeting interest payments and maturities involves financial operations of a relatively simple nature confined within our boundaries. A more serious problem arises when these bonds are held abroad. The funds required to meet such obligations have to be converted into foreign currencies. Large payments abroad tend to depreciate the external value of our money unit. Over 50 per cent. of our aggregate Dominion, provincial, and municipal indebtedness is held outside of Canada. Nearly 40 per cent. of our combined public debt is held in the United States; about 15 per cent. is held in Great Britain and other countries.

TABLE 27  
CANADIAN PUBLIC INDEBTEDNESS 1932-1933

	Total for Canada	Dominion	Provinces	Municipalities
Total Debt.....	\$5,471,883,736	\$2,717,929,651	\$1,368,883,144	\$1,385,070,941
Sinking Funds.....	377,406,129	66,030,717	81,017,540	230,357,872
Net Debt.....	\$5,094,477,607	\$2,651,898,934	\$1,287,865,604	\$1,154,713,069
Per Capita Net Debt	\$497.27	\$255.90	\$124.27	\$117.10

—Courtesy, A. E. Ames & Co., Limited.

The per capita Dominion, provincial and municipal indebtedness is \$497. This compares favourably with a per capita



*Courtesy A. E. Ames & Co., Limited*

FIG. 25.

public debt of \$830 in Great Britain. The latter figure is exclusive of local public debts. In Australia the per capita debt of the Commonwealth and the states, exclusive of municipal indebtedness, stands at \$885. In New Zealand the total public debt is \$1,116 per capita.

#### EXERCISES AND PROBLEMS

1. Outline the functions of government.
2. Why must the right of private property be enforced by law?
3. "Anything which would destroy faith in the sanctity of contracts would impair society's ability to carry on business." Explain.
4. Why is education the most remunerative of government functions in terms of an increased national output?
5. Discuss the labour and welfare legislation in force in your province.
6. Define public revenue; public expenditure.
7. What is a government budget?
8. State five reasons why a public spending body should draw a budget.
9. What is a tax?
10. Explain incidence of taxation.
11. What is a direct tax? An indirect tax?
12. Discuss proportional, progressive and regressive taxes.
13. Explain the benefit theory and the ability theory of taxation.
14. How is the real property tax levied?
15. Is the income tax based on the ability or on the benefit theory?
16. Why is the sales tax called a consumption tax?
17. Why is the gasoline tax said to be a selective tax?
18. State the chief factors responsible for the increase in Dominion, provincial and municipal indebtedness.
19. Show how public borrowing abroad by Canadians affects the rate of exchange.
20. If all the public debt of a country is held within a country, is the country as a whole richer or poorer?
21. Compare Canada's per capita public debt with that of other countries.

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